

# A Capital Idea

Realising value from  
environmental and social  
performance



*Prepared by Deni Greene Consulting Services  
with Standards Australia and Ethical Investment Services  
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## Executive Summary

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Financial success for business is increasingly linked to good environmental and social performance. Companies are subject to the ever-rising expectations of stakeholders, including customers, employees, the community, non-government organisations, and lenders, insurers and investors.

Mounting evidence shows that companies that are environmentally and socially responsible are more profitable and provide greater returns and lower risks to their shareholders. Eco-efficient firms are able to create greater shareholder value than their industry competitors while minimising environmental risk and impact.

### Changing investment analysis

Most financial analysts are still uncomfortable with numbers that are not expressed in terms of dollars, pounds or yen. A rapidly expanding group of analysts, researchers and investors, though, is able to understand factors such as tonnes of carbon dioxide, kilowatt-hours of electricity from coal-fired power stations, and parts per million of heavy metals. In addition to looking at financial issues, they are undertaking risk analyses that look at how exposed a company is to changes in climate change policy and how much progress it has made towards eco-efficiency and sustainability.

They are even able to consider the risks and benefits associated with a company's approach to other aspects of social responsibility, like accountability, performance in overseas countries, and community involvement.

The research information developed by this new breed of analysts is being translated into the creation of investment vehicles that reflect the improved outlook for companies with good environmental and social performance. Large and small shareholders are also using the results to engage company management on the need for lifting its game. Increasingly, mainstream investment research is beginning to realise the need to take account of the types of environmental and social information that it has long ignored.

The dramatically increasing size and power of superannuation funds in Australia, coupled with greater ability of members to choose their own funds, and with the massive increase in share ownership, will have a significant effect on the scrutiny of company performance.

People want to invest in companies with good reputations, and they want their investments to reflect the values they hold. As they come to realise that investing in socially responsible companies doesn't have to mean foregoing desired financial returns, they will look closely at where their money is being invested and they will ask questions, and they will act. Companies whose activities can stand up well to such scrutiny will benefit from this evolution; others will lose out.

### The need for clear communications

An essential part of good performance is clear, accurate and transparent communication. Some companies are already benefiting from making their environmental and social performance known to the financial community. These aren't the companies that engage in 'greenwash' to obscure their real activities. (Such tactics are rapidly discovered and reported around the world.) They aren't limited to the companies that have long recognised that their environmental activities were subject to controversy and that they had to aim for world's best practice.

Companies in fields of growing importance, such as renewable energy, health care, and environmental management are capturing attention. So too are companies in more traditional businesses who are taking meaningful steps to be socially responsible, even if their normal activities do not create significant environmental or social impacts.

## Changing demands and opportunities

Public and investor expectations of Australian business have never been higher than today. The vast majority of Australians think it is not enough for companies to make a profit, pay taxes, obey all laws, and employ people. Business is now expected to contribute to broader societal goals as well as attend to its own operations. The financial community too is asking new questions of business.

Gone are the days when a company only needed to satisfy its shareholders. Today customers and investors are rewarding companies that they see as socially responsible and punishing those seen to have a poor environmental or social performance.

Pressure on companies is taking many forms. A company's performance on issues of social responsibility has become an indicator of likely success in attracting and retaining talented employees. Shareholder advocacy is growing. Lenders and insurers are seeking to protect themselves against risks resulting from a company's past, current or future activities.

Businesses obtain direct financial benefits from operating a business in an eco-efficient manner, both in terms of cost savings and in improved profitability and achievement of a competitive advantage. They also acquire indirect benefits, because a good reputation is a major asset: enhancing the desirability of companies' jobs, attracting customers, improving productivity, affecting investor attitudes and confidence, and influencing relationships with government and other companies.

## A new breed of investors

Capital markets in Australia have changed markedly over the past decade. In 1991 only 15% of adult Australians owned shares; today the figure is 52%. Australians now have the highest rate of share ownership in the world. The rate of ownership is growing fastest among young people. Ownership remains highest among people with higher education and higher income. Young people and people with higher education and higher income are also the groups most likely to be concerned about environmental issues.

Socially responsible investment (SRI) is attracting great interest worldwide. Activity has increased dramatically in Australia, and a large number of new SRI funds have been introduced to the Australian market, many from firms such as Westpac, AMP, Tower, Challenger, Rothschild and other organisations well known to mainstream investors.

## What is socially responsible investment?

SRI funds typically are screened to reflect environmental, social or other non-financial values. Socially responsible investors may focus on a range of different issues, but the area of highest interest in Australia is the environment. Some socially responsible investors engage in shareholder advocacy, exercising their voting rights to encourage improvement in a company's environmental or social performance.

Companies that want to appeal to as wide a spectrum of investors as possible need to become familiar with the way socially responsible investors select their investments. A number of criteria beyond financial performance may be used. Typical SRI approaches used in selection of potential investments include:

- negative screens - to avoid some types of investments, eg gambling, pornography, tobacco, weapons, or companies with poor environmental or social records.
- positive screens - to exercise a preference for some activities or characteristics, eg companies in future-oriented industries, such as biotechnology, renewable energy, and health care, or companies with good environmental and social performance.
- best of sector screens - to select leading firms in every business sector, based on environmental and social performance or sustainability.

- constructive engagement - to select funds using traditional financial criteria but adding an overlay to engage with companies about troublesome areas of their performance.
- use of an index of environmentally and socially responsible companies - to follow an approach well known in traditional markets for constructing portfolios, except using different indexes.

Researchers provide socially responsible investors with analyses of companies in different forms: some develop company profiles, merely setting out the information about companies; others produce ratings of companies based on their performance in SRI areas; others provide detailed analyses, but do not rank companies. Information about overseas activities of Australian companies is becoming more readily available through the spread of SRI research networks worldwide.

## How can companies attract 21st century investors?

Meeting the expectations of investors and other stakeholders means conducting business in an environmentally and socially responsible manner and communicating information about company activities in a form that stakeholders find useful and transparent.

Elements of good environmental and social performance vary among industries. Companies in the resources and large manufacturing areas are already well acquainted with many of the components of good environmental practice. These issues may not be as familiar to industries typically considered less environmentally significant. Many companies are relatively unused to examining their social performance. This guide identifies key environmental and social issues for different types of industries.

All industries can benefit from taking stock of their current environmental and social performance, evaluating strategic directions for improvement, and implementing appropriate changes. Checklists and self-assessment questionnaires identified in this guide can be useful in these activities.



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# Introduction

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This guide is intended to assist Australian companies in capturing value from good environmental and social performance. It is the first Australian publication to show business how the changes in financial markets, including the rising interest in socially responsible investment, will affect their companies, and how they can benefit from these changes.

The guide has five parts. The information in each part is shown below. Each part can be read on its own because it covers a different feature of the financial, environmental and social context in which Australian business operates today. Taken as a whole, it provides a clear understanding of major challenges and opportunities facing Australian business today and in the future.

## Who is the guide for?

**Parts 1, 2 and 3** of this guide are aimed primarily at senior executives and managers of Australian companies, particularly those concerned with financial performance and the attraction of capital from investors and lenders.

**Part 4** is aimed primarily at environmental managers, human resource managers, and others involved in managing and improving companies' environmental and social performance. Senior executives might be interested in looking at the lists that identify environmental and social issues for different types of businesses.

**Part 5** is aimed at any readers who want to obtain additional information on the topics covered in this guide.

## What is in this guide?

### **PART 1— Business for the 21st Century and Beyond**

Describes the changing financial and social context for Australian business, and answers the following questions:

- What are the changing demands by society and investors that affect Australian companies?
- What actions are customers, investors and other stakeholders taking to back up their demands?
- How does meeting stakeholder demands for good environmental and social performance affect a company's financial performance?

### **PART 2— Investors for the 21st Century and Beyond**

Shows how dramatic changes occurring in investment and investors will affect Australian companies. It answers the following questions:

- What demands does expanding share ownership in Australia place on companies?
- What does growth in superannuation funds mean for investment in Australian companies?
- What level of socially responsible investment is occurring in the overseas countries where Australian companies might seek investment?
- How is the explosion of interest in socially responsible investment in Australia affecting requirements for good environmental and social performance by Australian companies?
- Why would investors looking for good financial return be attracted by socially responsible investment?

## PART 3—Attracting 21st Century Investors

Shows how an Australian company's environmental and social performance fits into the context of attracting investment capital. It answers the following questions:

- How do socially responsible investors and investment funds select companies in which to invest?
- What methods are used to evaluate and compare performance of different companies?
- How can Australian companies demonstrate good environmental and social performance?

## PART 4—Demonstrating Good Environmental and Social Performance

Helps a company ensure that its environmental and social performance matches or exceeds the expectations of today's investors and lenders. It answers the following questions:

- How can you gain an objective view of where you are now?
- What are the important environmental and social issues for your business?
- How can you determine strategic directions in environmental and social performance?
- What changes do you need to implement to improve your performance?

## PART 5—Some Useful Resources

Provides leads to useful sources of additional information. It covers the following areas of interest:

- Environment and sustainability for business and the finance sector
- Environmental and social reporting
- Corporate social responsibility and socially responsible investing

## How was this guide prepared?

Many members of the financial and business community have made important contributions to the preparation of this guide. Initially, the authors circulated a framework for the guide to a broad cross-section of people. Responses provided suggestions for the types of information that should be included, examples of companies that are demonstrating key aspects of good environmental and social performance, and views on many other issues.

The authors sought out and carefully examined a wide range of the most recent and authoritative sources of information from both Australia and overseas so readers could be provided with the most current information available.

About 30 members of the financial and business communities thoroughly reviewed draft copies of the guide and provided detailed comments and suggestions for improvement. The document you are reading is the outcome of this process and will, hopefully, provide a valuable new tool for Australian businesses in taking advantage of the many opportunities that can result from good environmental and social performance.

Principal author of this guide is Deni Greene Consulting Services. The guide has been prepared with Standards Australia and Ethical Investment Services. Funding for this project was provided by the Commonwealth Government through Environment Australia's Business of Sustainable Development (BSD) initiative. The staff of the Sustainable Industries Branch of Environment Australia provided invaluable assistance in the guide's preparation.

# PART 1— Business for the 21st Century and Beyond

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The phrase ‘from shareholder to stakeholder’ describes the shift in perspective being required of companies today. Where companies used to consider themselves successful if they kept their shareholders happy through good financial returns, today they are asked to satisfy many more interest groups on a much broader set of issues than financial return alone.

Growing numbers of Australian companies are coming to terms with their need for good environmental performance, although it is still common to equate good performance with merely meeting relevant legislative requirements. Many of societies’ expectations, however, fit uncomfortably with the role that companies typically consider appropriate for business. And the term sustainability, though frequently used, may be only vaguely understood and its relevance to company activities not clearly perceived.

This first section of the guide examines the business and societal context which Australian companies must be aware of if they are to continue to succeed. It also demonstrates why outmoded compliance-oriented approaches to environmental and social performance will become increasingly untenable in financial terms as requirements on companies tighten. Eco-efficient approaches offer not only better environmental performance, but also demonstrably improved financial returns.

## Part 1 covers the following topics:

- changing demands on companies
- the drivers for these changed demands
- the business case for environmental and social responsibility

## Changing demands on companies

*“The expectations for multi-national corporations are rising rapidly. At the same time, our own understanding of what we need to do to grow our business has become much more sophisticated. We understand [that] the triple bottom lines of sustainability—environmental, social, and economic—must all be addressed in order for us to be successful.*

*I personally believe that sustainability is the most important issue facing ... industry ... in the 21st century. We look at it not just as a requirement, but as an incredible opportunity. I see a day when everything my company does—our facilities, our products, our services—contributes to a sustainable future. We have an opportunity to have a major positive impact on society. We cannot afford to miss this opportunity.”*

William Clay Ford, Jr.  
Chairman, Ford Motor Company

More than 90% of Australians want large companies to go beyond their historical role of making a profit, paying taxes, employing people and obeying all laws; they want companies to contribute to broader societal goals as well. Almost half the Australian public believes that companies should “exceed all laws, set a higher ethical standard and help build a better society for all.” The Millennium Poll, a worldwide survey of over 25,000 people in 23 countries showed that Australians had the highest expectations of company performance.<sup>1</sup>

People’s impressions of individual companies were most affected by the company’s social responsibility: its labour practices, business ethics, and environmental impacts. Only 32% of people said their impression of the company was based primarily on business fundamentals, like financial factors, size, and strategic management, compared to the 49% that cited social responsibility as their main influence.<sup>1</sup>

In the recently released UK report *Winning with Integrity* produced by the Business Impact Task Force,<sup>2</sup> the 12 business organisations that signed the report stated that for business as well as for social reasons, all organisations should commit to carry out their business in a socially responsible way and uphold the following key principles:

- To treat employees fairly and equitably
- To operate ethically and with integrity
- To respect basic human rights
- To sustain the environment for future generations
- To be a caring neighbour in their communities

In a *Financial Times/PriceWaterhouseCoopers* “Most Respected Companies” survey<sup>3</sup>, 750 chief executives across Europe were asked their views on the most important business challenges for companies.<sup>3</sup> The top three challenges listed were:

- recruitment of skilled staff
- increasing pressure for social responsibility
- increased environmental demands

Increasingly, companies are being told that they must pay attention to such complex issues as corporate social responsibility, ethical and responsible practices, corporate governance, human rights, and others. Many of these terms are defined in a myriad of ways, making it even more difficult to come to terms with them. Yet it is becoming clear that companies who ignore these issues do so at their own peril. The importance of these issues to both business success and community satisfaction has been acknowledged in the UK, where a Minister for Corporate Social Responsibility works with both industry and government.<sup>4</sup>

London’s venerable *Financial Times* recently editorialised:

*“Last week was a bad one for some very big corporate names. The problem was not about their results, but about their public images. Chocolate manufacturers were accused of turning a blind eye to child slavery in the cocoa industry. Pharmaceutical giants were forced to abandon their lawsuit in South Africa to protect their patents on anti-AIDS drugs. British Petroleum, the most overtly socially aware of the international oil companies, faced criticism from shareholders and protesters at its annual meeting.”*

*Big companies are also discovering that criticism is coming not only from isolated outside protesters but from big shareholders, too. ... the cases demonstrate a trend: demands for greater social responsibility from business are getting louder, better organised, and more popular. They cannot be ignored.”*

Financial Times (London), 23 April 2001,  
editorial “Good names.”

The consequences of ignoring the strength of pressures for social responsibility mean that companies must look carefully at their operations and their relations to the community. They will find it essential to look at the types of actions a company must take to be considered socially responsible. Evidence is mounting that without such actions, companies will have difficulty prospering over coming years. As the international survey in 2000 by the Prince of Wales Business Leaders Forum found:

*“Corporate social responsibility has shifted decisively from the realm of ‘nice to do’ to the realm of ‘need to do’ not just because it is a serious and sustained interest of consumers but also because opinion leaders recognise this fact and will act accordingly.”<sup>5</sup>*

## Corporate social responsibility

As indicated above, business and other stakeholders are increasingly recognising the importance of corporate social responsibility. Many individuals and groups have defined corporate social responsibility in different ways. Several of these definitions, with some variations in emphasis, are shown in Box 1.

Some of the aspects of corporate social responsibility – fiscal and environmental issues and the need for accountability – are familiar to many companies in Australia, but certain social issues may be relatively new to them. These issues are beginning to be explored by business groups and non-governmental organisations. The State Chamber of Commerce (NSW) has recently produced an overview of corporate social responsibility in Australia.<sup>9</sup>

The Centre for Corporate Public Affairs with the Business Council of Australia produced an extensive report on Corporate Community Involvement,<sup>10</sup> one important aspect of corporate social responsibility. This report includes numerous case studies of Australian companies’ activities in this area.

## Box 1

### What is corporate social responsibility?

- A company's obligation to be accountable to all of its stakeholders in all its operations and activities.
- Socially responsible companies consider the full scope of their impact on communities and the environment when making decisions, balancing the needs of stakeholders with their need to make a profit.<sup>6</sup>
- An organisation's commitment to behave in an economically and environmentally sustainable manner, while honouring the interests of direct stakeholders.<sup>7</sup>
- The commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life.<sup>8</sup>
- Doing well by doing good.<sup>5</sup>

The dimensions of corporate social responsibility also vary among different definitions. It typically includes the following issues, which are examined further in Part 4:

- workplace issues—recruitment policies, treatment of employees, health and safety
- environmental issues
- human rights
- community involvement and development
- marketplace issues—characteristics of products; marketing; timely payment of bills
- fiscal issues
- accountability
- corporate governance and ethics

Corporate social responsibility also extends to the role of companies in influencing public policy. Increasingly companies and the industry organisations that represent them are recognising that they cannot take positions that benefit themselves but are detrimental to the interests of many other stakeholders.

In Australia, business groups worked closely with welfare organisations in advocating tax reform, and the Australian Conservation Foundation and the Farmers Federation combined to work for action to address issues of land degradation. Some companies have taken positions on

### KPMG—facilitating social responsibility and sustainability

Australian investors' attitudes towards socially responsible investment were surveyed for the first time through a survey commissioned by KPMG with Resnik Communications. The report of the survey results was widely distributed at no charge. This survey related closely to KPMG's work providing ethics consulting services and developing an ethics training board game.

KPMG Sustainability Advisory Services helps organisations understand and manage the balance between the financial, environmental and social dimensions of their activities, maximising long term stakeholder value and minimising exposure to unforeseen risks.

They recently benchmarked the sustainability reporting performance of the top 50 Australian companies against others in their industry sector, and international best practice.

For further information see [www.kpmg.com.au/](http://www.kpmg.com.au/)

climate change and the Kyoto Protocol that recognise the need for collective action to reduce greenhouse gas emissions.

Part 5 of this guide provides a selection of useful resources for companies to obtain more information about corporate social responsibility issues.

### Codes of conduct

Many Australian companies have adopted codes of ethics or codes of conduct, and others are beginning to recognise the need to do so. The codes adopted by companies have varied over time. Researchers have identified five generations of codes of conduct.<sup>11</sup> The earliest codes dealt primarily with conflict of interest issues. These were followed by codes that included provisions addressing commercial conduct. The next issues to be included were employee and other third party concerns. After that, codes began to address community and environmental issues. More recent codes of conduct have also included issues of accountability and social justice.

Codes of conduct have evolved in response to the growing expectations of business, both within the companies themselves and by other stakeholders.

## Mounting environmental and stakeholder pressures

Australians consider the environment to be a very important issue. An international poll by Environics in November 2000<sup>12</sup> found that 90% of the people surveyed in Australia expressed concern about the environment. The Australian Bureau of Statistics (ABS) determined in March 1999<sup>13</sup> that 68% of households were concerned about environmental problems. To a large extent, people believe that industry in Australia is responsible for most environmental problems, and is not working hard enough to ensure a clean environment.<sup>12</sup>

Air pollution was ranked as the most important environmental issue, with water pollution second, in both the international poll in 2000 and the ABS survey in 1999. The ABS survey found that concerns about ocean/sea pollution, destruction of trees and ecosystems, and garbage/rubbish disposal were the issues that ranked next behind air and water pollution. Opinions about the most important issues varied somewhat in different states.

Opinion leaders canvassed in the international Prince of Wales survey on corporate responsibility identified the environmental issues that they thought good corporate citizens should focus on in the 21st century. The top issues were: pollution to air and water (57%), waste and recycling (47%), climate change 31% and resource and energy conservation (21%).<sup>5</sup>

Some other important findings by Environics in November 2000<sup>12</sup> are:

- 71% of the Australians surveyed stated that they are concerned about worldwide environmental problems as well as the Australian or local community environment. This concern for worldwide issues has increased markedly since 1997.
- Over half (53%) the Australian community believes that environmental problems have affected their health.
- Most people (89%) believe that environmental problems will affect the health of future generations.
- People believe that individuals themselves can make a difference. Nearly three-quarters (71%) stated that they would be willing to pay 10% more for petrol if the money raised was used to reduce air pollution. (A major disparity frequently exists, though, between the way people say they will act on environmental

issues and what they actually do.) Most people do not consider that Australian business and industry is doing enough to ensure a clean environment.

- The majority of people (66%) believe that action should be taken now on climate change, rather than wait for all the scientific evidence to be available. An even greater proportion of the Australian public (87%) believes that the Earth's climate and long-term weather patterns are changing.

Dramatic differences exist in Australia between the views of the public and those of company executives on the role of companies. The Millennium Poll<sup>1</sup> of 1000 Australians and the recent New South Wales poll of business leaders demonstrate this disparity. As noted previously, the Millennium Poll<sup>1</sup> found that:

*45% of Australians think the role of large companies is to "exceed all laws, set a higher ethical standard and help build a better society for all." Only 8% of Australians see the company's role as limited to making a profit, paying taxes, employing people and obeying all laws; 47% of Australians see the appropriate role as being between the two.*

The New South Wales Poll<sup>9</sup> showed that:

*Only 2% of business leaders see the role of the company as exceeding all laws, setting a higher ethical standard and helping build a better society for all. 24% think the role of the company is to make a profit, pay taxes, employ people and obey all laws. The remaining 74% of business leaders see the company's role as being between the two.*

The authors of the New South Wales corporate social responsibility report, in presenting these results, comment: "These two findings suggest a gap between the expectations the Australian public has of business and the role Australian businesses see for themselves."

The survey results of public attitudes are evidence that environmental pressures on Australian companies are already substantial and will not decline in the near future. Given the link between environmental and financial performance, this should provide a further incentive to companies to look for ways in which good environmental performance can provide opportunities for adding value instead of being a cost or difficulty.

## What are the drivers for these changes?

The surveys described in this guide show that the community now expects companies to take a more

proactive role in creating positive change. It is also demanding better environmental performance, and expects business to act as a good citizen.

### *Action by customers and the community*

Business, institutional, and individual customers are exercising their buying power to put pressure on business to perform responsibly. Preferential purchasing programs of businesses, governments and universities reward companies and products that are seen as preferable for environmental or other reasons, such as having been made in Australia, or using ethical labour practices.

Responding to the Millennium Poll, 51% of Australians said that during the previous year they had punished a company seen as not socially responsible.<sup>1</sup>

A recent NSW Chamber of Commerce report cited Australian studies showing that 60% of all consumer decisions are made with an awareness of environmental impacts. The studies also found that 73% of people stated that if the quality was the same, they would prefer to buy a product associated with a good cause, and 49% said they would switch brands if necessary.<sup>9</sup>

An Australian study in mid-2000 (the Resnik/KPMG study) found that 75–82% of the people surveyed said they had bought products on the basis of social or environmental issues over the previous year.<sup>14</sup>

Many Australians have ready access through the Internet to an array of information on the worldwide actions and operations of corporations. Some sites such as US-based Responsible Shopper provide well-researched details on companies' performance on workplace issues, environment, and disclosure<sup>15</sup> ([www.responsibleshopper.org/](http://www.responsibleshopper.org/)).

While there is no Australian equivalent of the Responsible Shopper website, a large number of the companies profiled on the US site (or their Australian subsidiaries) are major suppliers of products sold in Australian supermarkets. Some Australian sites provide more limited information on 'ethical' or 'green' shopping.

Sites produced by advocacy groups provide advice and assistance to individuals or organisations wanting to mount campaigns or boycotts against companies on the basis of environmental performance, labour practices or other criteria.

Current actions related to production and sale of genetically modified food in Australia and overseas demonstrate how customers are making their preferences very clear to manufacturers, retailers and the government.

The use of class actions has been a common tool used to advance social responsibility among companies in the United States since at least the 1960s, and became possible in Australia in 1992.<sup>16</sup> Since that time, there have been a considerable number of class actions aimed at Australian companies. Many have dealt with issues relating to defective products – from pacemakers to peanut butter – and virtually all could be seen as addressing some aspect of social responsibility.

Environmental issues have been the subject of a number of suits: several arose as a result of damage from mining, some others related to oyster contamination, effects of emissions from smelters, exposure to Legionella, and drinking water quality.<sup>17, 18, 19</sup>

### *Changing role of government*

Government approaches to achieving improvement in industry's environmental performance were modified a number of years ago – expanding beyond extensive 'command and control' environmental regulation to encompass the use of market mechanisms to promote good environmental performance.

Regulation is essential to bring about action by laggards, and to provide a means of limiting the amount of pollutants a company emits to the air and water. It can also mandate disclosure of environmental information. Market-based mechanisms are, however, likely to be more effective in encouraging a company to undertake eco-efficiency or cleaner production approaches to prevent the creation of waste and pollution.

This reflects a growing awareness that improved environment performance presents opportunities that directly improve the bottom line for companies and that market forces are creating these opportunities. Government agencies in Australia frequently establish partnerships with companies to develop champions for new environmental approaches.

Environmental organisations, which have traditionally looked to government to bring about environmental improvement in industry, are now focusing much more of their efforts directly on the companies themselves.

### *Pressures applied along the supply chain*

A growing number of companies are imposing requirements on their suppliers to ensure environmental performance. Within Australia, Ford, General Motors Holden, Toyota, Unilever, and Rio Tinto are among the companies imposing environmental requirements on their suppliers. Typical requirements include development of an environmental management system or preparation of a public environmental report. There is a trend for companies to be held responsible by consumers and investors for their suppliers' environmental performance or labour practices, so some companies are establishing codes of conduct for their suppliers' operations as well as their own.

Some companies are seeking to improve their own performance by working with their suppliers to incorporate recycled materials in packaging, make other modifications to their products, or to take back packaging after use. As an example, Telstra arranged with mobile phone manufacturer Ericsson to take back packaging after delivery to Telstra's retail operations.<sup>20</sup>

#### **Schiavello encourages good supplier performance**

Schiavello Commercial Interiors, an Australian company with headquarters in Melbourne, has taken steps to improve its own environmental performance through adopting and implementing an environmental management system, making major efforts to improve energy efficiency, and employing a full-time environmental manager to coordinate activities and communicate with staff and stakeholders.

Schiavello also encourages its suppliers to improve their environmental performance. Suppliers or contractors who want to be listed on Schiavello's preferred supplier list must complete a questionnaire that includes a series of questions on environmental management. At this time, the responses to the environmental questions are for information only, but they clearly indicate to suppliers that Schiavello is interested in their actions. The questions cover use of resources, emissions, energy, waste, generation of greenhouse gases, and closed-loop handling of materials.<sup>21</sup>

### *Pressure from within the organisation*

Employees and directors of a company are often among the most important sources of pressure for change in an organisation. Sometimes they are reflecting the external pressures placed on them by stakeholders, but at other times, their efforts reflect a desire to have the

#### **PPG and Cranwell – supplier and customer – develop EMS together**

A manager at PPG Industries worked with his customers operating small collision repair companies to help them prepare environmental management systems. He assisted Cranwell Collision Repair, a family owned business with 11 employees, in the western suburbs of Melbourne. Working together with PPG, Cranwell undertook major improvements and achieved ISO 14001 and ISO 9002 certification. These changes are saving the firm money, enhancing its reputation and providing safer and more pleasant working conditions. PPG provided this service to build customer loyalty and was assisted by a grant from EPA Victoria.<sup>22</sup>

company's actions remain in tune with their own values. Shell has publicly stated that in the mid-1990s, when employees told them that they were unhappy about some of the company's actions, the company realised that it had to make major changes in its policies on human rights, the environment, transparency, and other issues.

Companies that want to attract skilled employees and maintain their loyalty realise that they have to perform in a manner of which employees can be proud. Company values must therefore be demonstrated not only in mission statements and codes of ethics, but also in action, both domestically and overseas.

#### **Pressure from the financial services sector—lenders, insurers and investors**

The financial services sector is paying increasing attention to issues of corporate social responsibility. One of the reasons for heightened interest is awareness of the financial risks associated with poor environmental performance. Another motivation is the growth in socially responsible investment and shareholder action.

#### **Lenders**

Banks and insurance companies began to recognise the importance of good environmental management when the connection between environmental issues and risk became clear through the exposure of massive liabilities for contaminated sites. Climate change and the spread of salinity will raise similar issues.

To reduce their future risks some banks overseas have begun to look more closely at environmental management when considering business loans.<sup>23</sup> UK bank, Lloyds TSB has produced a booklet for companies explaining why good environmental practices make

businesses more competitive.<sup>24</sup> It has also developed techniques for taking environmental risk into account in business lending. Lloyds' TSB feels that it is better placed to assess a customer's all-round credit-worthiness if it understands the environmental risk the business faces and the measures it puts in place to counter those risks. Other banks in the United States and United Kingdom are beginning to take this approach, and Australian banks are following.

It is quite common for due diligence procedures to be required as part of major financial transactions, to demonstrate to a bank or other lender that there are no hidden environmental liabilities that could become the responsibility of the lender or that could diminish the value of the property or organisation.

### Insurers

Insurance companies faced the same types of financial liabilities as banks when they became responsible for costs of cleaning up contaminated land or for paying damages to workers injured by exposure to asbestos.

Some European insurance companies, such as ING, have an external environmental policy focusing on managing environmental risks in insured companies and on utilising new, commercially responsible market opportunities in the environmental area.<sup>23</sup>

The risk of massive payouts resulting from damage induced by climate change has also become an issue for insurance companies. In April 2001, AMP, until recently Australia's largest insurer, announced that it would not renew policies for home and vehicle insurance in the cyclone belt of northwestern Western Australia. It is responding to predictions that global warming could cause storms to become more severe and unpredictable, resulting in an increased risk of damage.<sup>25</sup> The large European insurer Munich Re employs a climatologist to provide information on the potential effects of climate change.<sup>26</sup>

At the July 1996 Conference of Parties to the Convention on Climate Change in Geneva, a large delegation of insurers turned up for the first time. Under the auspices of the UN Environment Programme, some 60 insurers, including multi-billion dollar companies such as General Accident, Swiss Reinsurance Company, and Sumitomo Marine and Fire Company, signed a statement calling on governments to substantially reduce emissions of climate-altering greenhouse gases.<sup>27</sup> Insurers recently estimated

that the cost of global warming could rise to about \$US300 billion per year by the year 2050.<sup>26</sup>

### Investors

The role of investors in promoting good environmental management is becoming more prominent, both in Australia and overseas. The past few years have seen the introduction of a substantial number of new Australian socially responsible investment (SRI) funds, employing screens that take into account environmental and social issues, as well as financial return. SRI funds are already a significant force in the United States and the UK, and they are beginning to garner considerable attention in Australia.

A survey of Australian superannuation members in 2000 found that 83% wanted to invest their superannuation in an environmentally screened fund. They would prefer screening to be based on positive environmental improvement rather than the denunciation of negative activities.<sup>28</sup> The importance of SRI funds in Australia will be discussed in Part 2 of this guide.

Investors are calling for superannuation funds to provide greater information about their investment policies. A diverse group of organisations including The Australian Conservation Foundation, other environmental and community organisations, the Australian Council of Trade Unions, a number of financial institutions, and other groups is campaigning for super fund disclosure legislation to be introduced in Australia.<sup>29</sup> In the United Kingdom, legislation adopted in 2000 requires pension funds (ie superannuation funds) to disclose:

*"The extent (if at all) to which social, environmental, or ethical considerations are taken into account in the selection, retention and realisation of investments and: their policy (if any) in relation to the exercise of rights (including voting rights) attaching to investments."*<sup>30</sup>

Funds managers are beginning to use their financial clout to impose environmental requirements on companies. Morley Fund Management, a major London-based asset manager, recently announced it would begin requiring large UK companies to publish environment reports.<sup>31</sup> Morley is the asset manager of CGNU plc, the UK's largest insurer and the world's sixth largest insurance group. It manages assets equivalent to 2.5% of the UK stock market. With this kind of market influence, Morley's policy changes are sure to be felt by a significant number of companies. "Identification of environmental risks and opportunities is becoming increasingly important for institutional investors," said Anita Skipper,

Head of Corporate Governance at Morley. “We believe that management ought to be actively considering steps to report publicly on their key environmental issues.”

Australian companies increasingly recognise that they operate within global financial markets. When companies are looking for sources of capital, whether for major investments or venture capital, they try to attract overseas, as well as Australian, financial interest.<sup>32</sup> The growing emphasis placed on social responsibility by financial institutions worldwide should provide an added incentive to companies to take steps to ensure that their performance on environmental and other social responsibility issues would make them attractive to these investors.

### *Shareholder action*

Shareholder action is also becoming more evident in Australia. As increasing numbers of Australians become shareowners, they are beginning to look more closely at the actions of companies they invest in. Interest groups are also recognising that introducing shareholder resolutions at company annual general meetings is a good way to call management attention to an issue. Section 249D of the Corporations Law was amended in 1998 to require a company to call a general meeting if requested by at least 100 registered shareholders (prior to the amendment, only shareholders with a combined 5% share capital could call for a general meeting).

World Consumer Rights Day on 15 March 2001 focused on corporate responsibility through ethical investment or shareholder action. Louise Sylvan, chief executive of the Australian Consumers' Association, stated, “we're encouraging consumers to ask their fund managers to have their investments positioned more ethically.”... “If consumers don't have a lot of time themselves to do research on companies, we ask them to join organisations that are in the business of publicly shaming companies whose conduct is not exemplary.” Ms Sylvan said, “The cases of Shell and of the Nike campaign, show that these huge companies are vulnerable, particularly when the action affects the reputation component of their stock prices. The boardroom does listen. It's a technique that has to be used strategically but it does work.”<sup>33</sup>

In the United States, interest groups are introducing shareholder resolutions and using them as a lever to encourage the company to negotiate and agree on a set of implementation actions prior to an AGM, so that the resolution can be withdrawn. These investors are using

the shareholder resolution process to pressure companies to change policies and increase disclosure on a wide range of corporate social responsibility issues, including environmental management, workplace policies, community involvement, human rights practices, ethical decision-making and corporate governance. Activist groups are also buying shares in targeted companies to provide access to annual meetings and the shareholder resolution process.

A Greenpeace International document, “*Making it Happen*,” is aimed at encouraging shareholder action, claiming, “Business is now the only institution in the modern world powerful enough to foster the changes necessary for ecological and social sustainability.”<sup>34</sup>

Many of the shareholder actions introduced in Australia have focused on corporate governance issues, such as large payments to retiring directors or officers, but in the past few years there have been some resolutions concerned with social responsibility and environment issues. In September 1999, the Wilderness Society WA organised Wesfarmers shareholders to call an extraordinary general meeting (EGM) to vote on resolutions on the company's woodchipping operations. A month later, environment groups organised North Ltd shareholders to call an EGM to vote on resolutions on one of the company's mining operations.

An international shareholder campaign aimed at Rio Tinto was conducted by trade unions, including the ACTU in Australia. In the two years before the shareholder campaign, ie between 1998 and 2000, unions in 14 countries carried out an international campaign that included industrial action and public protests. In 2000, unions in Australia, the UK and the US initiated a Rio Tinto Shareholder Coalition to submit two resolutions to Rio Tinto's AGMs. (The company holds two AGMs, one in the UK and one in Australia.)

The first resolution was directed at achieving a majority of independent directors on Rio Tinto's board. The other called on the company to implement a workplace code of labour practices at its operations worldwide. The first resolution gained 20.3% support and the second, 17.3%, as a combined result from the two AGMs. Although the resolutions did not achieve a majority of support in the AGMs, Rio Tinto implemented many of the measures called for by the shareholder coalition.

In the United States, institutional investors are using their enormous financial power to push for change across a

range of areas. Environmental issues are high on the agenda of these US institutions, and the hundreds of shareholder resolutions in 2001 cover such topics as:

- Reporting on greenhouse gas emissions
- Phasing out chlorine from papermaking
- Reporting on environmental liability issues
- Reviewing or ending specific projects seen to be environmentally damaging
- Promoting renewable energy resources
- Linking executive pay and environmental performance
- Reducing impact on biodiversity and indigenous peoples
- Adopting a policy on non-toxic chemicals
- Phasing out PVC products
- Phasing out genetically engineered foods
- Endorsement of CERES Principles (international environmental reporting principles, formerly called the Valdez principles)

The companies to whom these resolutions are addressed are among the largest in the United States, and the overwhelming majority are well known in Australia. Notably too, all these issues have relevance to Australian companies.

It seems likely that the trend toward shareholder resolutions will accelerate in Australia as shareowners become more sophisticated about their potential. Sharan Burrow, President of the ACTU has called for greater activism by trustees of superannuation funds.<sup>35</sup> In a speech to the Sydney Institute, she stated “democratising the economy will become a goal for working Australians who, as shareholders, do not want their financial returns to come at the expense of social concerns such as the environment and human rights.”

Burrow cited a recent report on proxy voting by the University of Melbourne as evidence that proxy voting will become more important in the future. The report’s conclusions (which are only advisory) are that legally voting rights are assets of the funds and must be dealt with by trustees in the interest of the beneficiaries. This means, she said, that trustees must adopt principles on

voting proxies and monitor fund managers if voting rights are delegated to them.

A relatively low percentage of proxies have generally been voted in Australia. Large institutional investors maintain, though, that they do vote their proxies. Responding to a February 2001 survey for the Investment and Financial Services Association Ltd, fund managers reported voting on 67% of resolutions, and the majority of managers said they vote on 90% of resolutions.<sup>36</sup> Nevertheless, the 41% of proxies voted in Australia compare unfavourably to the 80% in the United States, 73% in Germany, and 50% in the United Kingdom.<sup>37</sup>

### *Calls for greater transparency and disclosure*

Companies are being asked or required to produce more and more detailed information about their environmental performance. Demands for transparency and disclosure are coming from a broad range of stakeholders: customers, investors, regulators, community groups, environmental activists, suppliers, and others. The public has established its ‘right to know’ about hazards that might affect the environment and/or their health. The financial community is recognising the links between environmental and financial performance and the risks associated with poor environmental performance.

Australian companies and governments have traditionally released far less information about their operations than their US counterparts. This disparity has become relatively untenable since the advent of the Internet, because it is frequently possible to find out information on a company’s activities in Australia through consulting public sources in the United States.

The situation on disclosure is changing in Australia. One indication of this is the requirement in the Corporations Law (Section 299[1][f]) for medium and large companies to include information about their environmental performance within their Annual Reports.

A growing number of Australian companies are producing stand-alone public environmental reports, and the quality of the reports is improving rapidly. Several organisations have rated the quality of the reports and some have provided rankings intended to assist companies in improving their reports<sup>38, 39, 40</sup> The Commonwealth Government has issued a framework for Public Environmental Reporting. Available at:

[www.ea.gov.au/industry/sustainable/per/publications.html](http://www.ea.gov.au/industry/sustainable/per/publications.html)

Pressures are also mounting for reporting to cover more than environmental issues, to address social issues and sustainability issues, ie to report on the triple bottom line.

One of the criticisms of Australian and overseas public environmental reports is that they are difficult to compare. Unlike the presentation of financial information, no standards are used to determine what type of environmental information is included, what is excluded, and how information is presented. The Global Reporting Initiative, an initiative of CERES (Coalition for Environmentally Responsible Economies) and the United Nations Environment Programme, is working toward the development of a foundation for standardized (or uniform) corporate sustainability reporting worldwide.<sup>41</sup>

Additional examples of the growing interest in disclosure are the requirements of EPA's and the Commonwealth Government related to emission of pollutants, including the National Pollutant Inventory.

### *Combined effect of the pressures*

The range of pressures on companies is certain to have profound effects on any Australian business that wants to survive in coming years. The authors of the Millennium Poll concluded "the strength and breadth of the findings from ... the largest-ever global survey of public expectations of corporations suggests that major companies in the 21st Century will be expected to do all of the following:

- demonstrate their commitment to society's values and their contribution to society's social, environmental and economic goals through actions
- fully insulate society from the negative impacts of company operations and its products and services
- share the benefits of company activities with key stakeholders as well as with shareholders
- demonstrate that the company can make more money by doing the right thing, in some cases by reinventing its business strategy. This "doing well by doing good" will reassure stakeholders that the new behavior will outlast good intentions"<sup>41</sup>

### *Just good business*

A company's performance and attitudes on issues of environmental management, cleaner production, eco-efficiency, product quality and innovation, and social responsibility, as well as its contribution to a sustainable

future, can positively affect its financial performance both directly and indirectly.

Direct effects will come from reducing costs through energy efficiency, eliminating waste, decreasing risk, incurring fewer penalties for environmental, health and safety or other violations, reducing use of raw materials, and from increasing sales through greater competitiveness.

Indirect effects will result from improvements in the company's reputation, which in turn has been shown to increase sales, assist in attracting and retaining staff, improve productivity of staff, affect share price, and reduce the cost of capital.

Box 2 shows the evolution that has occurred in companies approach to environmental management, and the effect of the changes on financial performance. Many Australian companies may still be operating in the manner that EPA called Phase 1, and may be missing out on the opportunities available to them from taking a more proactive approach to environmental management. Separate studies by Deni Greene Consulting Services<sup>43</sup> and the Australian Industry Group/Monash University<sup>44</sup> in 1999 found that:

- few companies were familiar with eco-efficiency; compliance with regulations was the main driver for environmental action
- most still relied heavily on pollution control rather than prevention
- environmental regulations and occupational health and safety legislation were the most influential factor driving environmental management strategies, rather than the search for strategic opportunities
- mechanisms for forward-thinking strategic planning appeared to be weak. More than half the organisations surveyed react to changing conditions when they become a reality, rather than anticipate the changes and modify operations in advance. The majority of those interviewed relied mainly on their own experience and common sense for strategic business advice
- companies were not using cleaner production techniques systematically; they equated these techniques with installation of expensive new equipment or processes, so upfront expenditure was seen as a burden (even though they believed that longer-term savings would result)

## Box 2

### Three stages in the relationship between environmental and financial performance

The US EPA in 2000 set up a committee made up of business, financial and non-government organisation executives to study the connection between firms' environmental performance and financial performance.<sup>42</sup> They determined that the relationship between environmental performance and financial performance has evolved over time. They divided the evolution into three phases:

#### Phase 1—Minimisation of regulatory compliance costs

- companies saw environmental requirements as a drag on profitability and only a cost; so they tried to minimise them
- environmental performance was not seen as related to achieving business objectives
- financial opportunities that could be achieved through improved environmental performance were not being realised

#### Phase 2—Proactive approaches to environmental management

- redesign of industrial processes to prevent pollution—most often through recovery and use or sale of materials and chemicals that previously were discarded as a waste or emission
- reduced compliance costs and improvements in operating margins through greater energy and materials efficiency
- introduction of environmental audits and implementation of environmental management systems (EMSs) to understand and reduce their environmental impact in a more systematic way
- shift in attitude toward environmental regulation—some began to advocate incentive-based environmental regulation to allow flexibility
- eco-efficiency emerged, holding that redesign of production processes to reduce waste and environmental risk can improve operating margins, increase returns and lower working capital expenses
- financial gains, through improved environmental performance, were starting to be realised

#### Phase 3—Creation of value through environmental strategies

- product innovation—including products to be reused or recycled
- market redefinition—often from production of a product to provision of a service

- small organisations, in particular, were neglecting an important tool for identifying cleaner production opportunities because they rarely did audits of their environmental performance, and placed little value on them

Unless the picture has changed markedly in the past two years, many if not most Australian companies are still incurring costs for meeting environmental requirements, but are missing out on the opportunities for changing the equation.

### *Direct financial benefits*

A number of studies overseas have demonstrated the direct financial benefits from moving to more opportunity-oriented approaches to environmental management.

Geoffrey Heal writing recently in London's *Financial Times*<sup>45</sup> reported, "Even on a sector-by-sector basis, shares of companies with a superior environmental or human rights record appear to outperform. Clean chemical companies will outperform dirty ones, clean oil companies will outperform dirty oil companies."

This type of finding suggests a deeper and more intrinsic connection between responsible management and superior returns. In the case of the environment, superior performance is indeed linked to higher profits. Pollution is waste, and cutting back on or finding ways to reuse waste feeds back to reduced inputs and higher profits. Dow Chemical, DuPont and Anheuser-Busch have all found improved environmental performance to be a source of profits."

Heal, a professor at Columbia University in New York, contends that a similar effect may be at work with human rights. “Paying workers a living wage and protecting them from harassment may cost a little more in the short run, but if it improves morale and reduces turnover then it may still be good for profits after a few years. So socially responsible management practices may contribute directly to profits.”

Three significant studies concluded that good environmental performance would continue to increase in importance in the future. Hart stated that the technological, organisational, and human resources serving a firm’s environmental aims today should be even more important as industrial society evolves to a point where sustainable development is the norm.<sup>46</sup> A second study concluded that the increasing availability of environmental information “implies that the laggards in environmental performance will more likely suffer at the hands of consumers, while those following an effective proactive approach will thrive”<sup>47</sup> Cairncross observed: “the rise of environmental concern is perhaps the biggest opportunity for enterprise and invention the industrial world has ever seen.”<sup>48</sup>

Most companies in Australia are familiar with the principle of saving money through energy efficiency, reduction of waste, reduced compliance costs, and the reduction of risk—leading to reduced insurance premiums, less lost-time improvements, and sometimes of lower license fees. They may not have focused though on the potential for increased sales to customers who either require environmental certification and environmental reporting from their suppliers or are just conscious of the importance of good environmental performance. As the results of the Millennium Poll,<sup>1</sup> NSW Survey<sup>9</sup> and Resnik KPMG<sup>14</sup> studies showed, a substantial proportion of the Australian community rewards good environmental performers and punishes bad ones.

Analysts in the socially responsible investment arena usually analyse in detail a company’s environmental performance as part of its evaluation. One US investment research firm states:

*“It is now increasingly widely recognized by leading-edge investors and investment analysts that there is a significant and growing correlation between industrial companies’ eco-efficiency and their competitiveness and financial performance.*

*This eco-efficiency or sustainability premium can consistently exceed 200 basis points (2 percentage points) annually for broadly diversified*

*portfolios, and even surpass 500 bps (5 percentage points) in sectors with particularly acute risk exposure.”<sup>49</sup>*

Good environmental management has been shown to reduce a company’s risk. When coupled with good communication about environmental performance, that reduced risk means lower costs of capital and higher share prices.<sup>50</sup>

Analysing these results, Inman observed that the benefit of the risk reduction is relative, measured against the average for companies on the equity market. As more companies implement measures that reduce risk, as by pollution prevention (ie cleaner production) projects, ISO 14000 certification, etc, the market discounts the value of these efforts. Firms that have not undertaken such measures are thus left further behind.<sup>51</sup>

### *Implementing value-adding environmental approaches*

A recent analysis of the relationship between progressive, operational environmental management and shareholder value<sup>52</sup> concluded that only some types of environmental management activities significantly enhance shareholder value. These are activities that result in value adding for the company. Some characteristics of these activities are:

- Reduced capital intensity: software rather than hardware (‘smarter’, smaller, cheaper installations)
- Low-material-consuming: reduced throughput (lower purchase, storage and depreciation costs)
- Sales-boosting: increasing the benefit and attraction to customers (more desirable products and services for more customers)
- Margin-widening: increasing the benefit to customers and reducing the costs of producing the products and services (higher prices due to greater benefit and lower operating costs through improved operating efficiency)
- Safeguarding the flow of finance: confidence of the capital market (lower and less systematic risks, and (if applicable) ‘green bonus’)
- Long-term value-enhancing: anticipation of future costs and earnings potential

## Maintaining strict environmental standards worldwide

Large companies that adopt strict global environmental standards in developing countries are rewarded with higher stock market performance, according to a study published in a journal of the Institute for Operations Research and the Management Sciences.<sup>53</sup> “We have found a significant and positive relationship between the market value of a company and the level of environmental standard it uses,” say the authors.

Of the companies examined in the study, firms choosing to employ their own strict global environmental standard abroad are found to have an individual value of approximately \$10.4 billion higher than those using less stringent US standards, after controlling for the influence of physical assets, capital structure, and multinationality.

The article concludes that quality firms generate less pollution and strive to be the best in all their operations while lower-quality firms engage in what is described as a ‘race to the bottom’ to gain short-term financial advantage.

Organisational efforts to adopt sustainable approaches are driven by more than altruism. As the Chairman of DuPont said in 1996:

*“Industry has a next century vision of integrated environmental performance. Not every company is there yet, but most are trying. Those that aren’t trying won’t be a problem simply because they won’t be around by then.”<sup>54</sup>*

## Indirect financial benefits—The value of a good reputation

The financial benefits of good performance described above are readily understandable to most businesses. The issue of reputation, though, makes many people uncomfortable. When *The Age* and *The Sydney Morning Herald* published reputation rankings for Australia’s largest companies, many in business were quite critical. While some of the criticisms related to real shortcomings in the methodology used to derive the rankings, others reflected concerns about evaluating reputation at all, because it is intangible, not based on hard data. The link between reputation and financial value is often underestimated, but usually not by those who are most successful in business.

*“Our reputation, is our only asset,” wrote Warren Buffet, often referred to as the most successful investor in the United States. “Without it, we are worthless.”<sup>55</sup>*

A large proportion of many companies’ worth is made up of intangibles like reputation, brand name and recognition. The market capitalisation of a company often far exceeds the ‘property’ value of the company. For instance, as much as 96% of Coca Cola and a similar proportion of IBM is made up of ‘intangibles’—a major part of which rests on the reputation of the company. Weiser and Zadek cite an estimate by Interbrand that one-fourth of the world’s financial wealth is made up of intangible assets.<sup>56</sup>

Reputation affects most aspects of a company’s business. Environmental and social performance and efforts to move toward sustainability have major effects on a company’s reputation. The quality of a company’s reputation strongly influences:

- the attractiveness of a company’s jobs
- the products people buy
- staff morale and productivity
- how investors view a company
- the quality of relationships with others, including government and other companies, eg joint ventures, suppliers, customers
- media coverage
- staff recruitment and retention

Many business leaders rate recruitment of skilled staff as their greatest challenge.<sup>3, 57</sup> Employee turnover and other corporate culture issues are seen as presenting the greatest risk of failing to achieve corporate goals.<sup>58</sup>

Potential employees are more attracted to a company with a good reputation. Several studies have shown, too, that employees feel greater loyalty to companies with good reputations. MORI research found that the vast majority of people believe that a company that supports society and the community is a good company to work for.<sup>4</sup> Another study by Walker Information showed that good reputation led to more effective recruitment, higher staff retention, and better morale, loyalty, motivation and productivity.

The financial benefits of good employee morale have been demonstrated in research on the large US retailer Sears, published in the *Harvard Business Review*<sup>56</sup>. Sears found that a small improvement in employee attitudes creates an improvement in customer satisfaction, and

that leads to a 0.5% improvement in revenue. At Sears, 0.5% improvement in revenue means additional sales of \$US65 million per year. At its current after-tax margin and price-earnings ratio, those extra revenues increase its market capitalization by nearly \$US80 million.

### *Products and purchases*

Consumer buying power has been used for some time to reward and punish companies for their environmental and social performance. Anita Roddick popularised this trend with the Body Shop, and the outdoor clothing brand Patagonia has also successfully applied this approach. A number of companies have suffered when public campaigns discouraged purchases of products because of company actions seen to have a detrimental environmental or social effect.

Results of the surveys described earlier in this guide showed that up to 80% of Australians say they would punish or reward companies on the basis of whether or not the companies are seen as socially and/or environmentally responsible.<sup>1,9</sup>

In 1994, Walker Information undertook a comprehensive study in the United States, looking at corporate character and social responsibility. This study established that corporate reputation has a very strong impact on brand loyalty. It found that 47% of consumers stated that they would be much more likely to buy from a company that is socially responsible, and that 88% of consumers said they would be much or somewhat more likely to buy from such a company.<sup>57</sup>

### *Investor confidence—Share price*

Good environmental and social performance improves a company's reputation and lowers its risk. As described earlier (see section on attracting customers and investors), reduced risk may lead to an increase in share price.

A company's reputation also influences investors. Walker<sup>57</sup> found that 26% of investors say that the business practices and ethics of a company are extremely important to their investment decisions.

The experience of the Exxon Valdez oil spill in 1988 showed how vulnerable a share price is to a damaged reputation, at least in the short term. After the oil spill, Exxon's share price plummeted. The substantial depression of share price persisted for at least four

months after the accident. At the same time, other firms with poor reputations for environmental performance also suffered declining share prices, and firms with good environmental reputations saw their share prices rise.<sup>59</sup>

Illegal and irresponsible actions also damage reputation and substantially lower share price. A study of actions involving product recalls, environmental lawsuits, anti-trust lawsuits and fines by regulators showed that share prices dropped markedly and did not quickly (sometimes ever) recover.<sup>60</sup>

The spin-offs from a company's performance may be far-reaching. Environmental and social performance affect reputation, which affects how the media views the company, which in turn further impacts on the company. The way the media reports environmental performance was studied by examining media coverage after the introduction of the Toxics Release Inventory in the United States (similar to the National Pollutant Inventory in Australia.)

The US EPA distributed the inventory of releases (ie air emissions, offsite shipments of toxic waste, etc) to the media. The higher the pollution figures in a firm's toxics release inventory reports, the more likely print journalists were to write about the firm's toxic releases. Investors also took note of the results. The firms whose pollution figures were reported experienced negative, statistically significant abnormal returns in their share prices after the information was released. The abnormal returns translated into an average loss of \$USD4.1 million in share value on the day the pollution figures were first released.<sup>61</sup>

### *The vulnerability of company reputations*

A recent book by Grahame Dowling of the University of New South Wales cautions companies that their reputations must be built on their performance. He says "It is a mistake to entrust to a spin doctor the task of trying to build a better reputation."<sup>62</sup>

Richard Hall states that a company's reputation is its most important asset, but it is extremely vulnerable to change. The perceptions of any of the wide range of a company's stakeholders can make or break a reputation. He suggests that it can take up to 11 years to restore a damaged company reputation.<sup>57</sup>

## Conclusion to Part 1

Acknowledging the valid role of a wide range of stakeholders and coming to terms with their environmental demands is critical to the success of Australian companies in the 21st century. Companies are reliant on customers, investors, employees, and the community in which they conduct their business. These and other stakeholders are making clear that they will reward companies who understand and meet their demands for good environmental and social performance and will punish those that don't.

Part of coming to terms with the new and increasing demands of stakeholders is recognising that the company itself can benefit financially from improved approaches to environmental and social performance. Both direct and indirect financial benefits are available to Australian companies that use innovation and imagination to reshape their businesses for the 21st century and beyond.

It is important to recognise that the financial performance of a company is influenced by many factors in addition to environmental and social performance. Good environmental performance has been shown to benefit financial performance over the long-term, but short-term issues can have a significant overriding effect on a company's share price.



## PART 2— Investors for the 21st Century and Beyond

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Australian companies seeking external capital today and in the future will face a very different investment market than they would have even a decade ago. Half of all Australians now own shares, either directly or through a superannuation fund. Superannuation funds are the major investors in the Australian share market, and individuals will have increasing freedom to select a super fund whose policies are consistent with their own values.

Interest in socially responsible investment is spreading rapidly in Australia at present. This reflects the preference of Australians for considering social and environmental factors, in addition to the traditional financial ones, when they invest. It also is a response to clear evidence that financial returns of socially responsible investments match and often exceed those of more traditional investment.

Attention to environmental and social issues is, however, no longer limited to socially responsible investors; increasing numbers of mainstream investment firms are beginning to look at these issues across their entire portfolios. All these factors mean that Australian companies will be subject to increasing scrutiny in the future from investors who are very interested in the companies' environmental and social performance.

### Part 2 covers the following topics:

- major changes in Australian capital markets
- rising interest in socially responsible investment
- socially responsible investment going global
- performance of socially responsible investments

## Major changes in Australian capital markets

A profile of today's investors shows a very different picture than a profile developed a decade ago. With rising share ownership and the universal application of superannuation, a great many more people are now investors in Australian industry. The attitudes and preferences of the new investors are already being reflected in the dramatic rise in interest in socially responsible investment.

Over coming years, issues such as the environmental and social performance of companies, which are important to these investors, are likely to play a much larger role in influencing investor decisions than they have in the past.

### *Rising share ownership*

Australians have the highest rate of share ownership in the world: 52% of Australians own shares either directly or indirectly. In 1991, only 15% of adult Australians owned shares. Increasing coverage of superannuation, the take-up

of newly floated companies like Telstra and the Commonwealth Bank, and the demutualisation of NRMA are mainly responsible for this surge in ownership. Direct ownership of shares accounts for 40% of owners (up from 20% in 1997); 20% have indirect ownership through personal superannuation and 19% own shares indirectly through managed funds that invest in Australian shares.

Share ownership is now widespread among most sectors of the community. This means that the views of today's and tomorrow's shareowners are likely to be quite different from those of investors of the past. The fastest growth of share ownership is occurring among young people; the 18-24-age range showed the greatest growth, with 25-34 year olds close behind. These are the age groups that commonly demonstrate the greatest concern about environmental issues, and that concern is likely to be reflected in the way they select among companies or funds in which to invest.

Women make up 47% of Australia's direct shareowners.<sup>63</sup> This is substantially higher than it was only a few years ago. Share ownership rises among those with higher education and higher income. People with higher education and higher income are also the most likely to be concerned about environmental issues.

According to Richard Humphrey, Managing Director and CEO of the Australian Stock Exchange, "Well over half the value of Australia's total market capitalisation is held in Australia by Australians."<sup>64</sup>

Rising share ownership, along with increased awareness of corporate social responsibility issues, will raise interest in the activities of Australian companies. It is interesting to consider what that rising interest will mean, in light of the high expectations of business revealed by the Millennium Poll. Increased interest in the activities of Australian companies will very likely involve much closer scrutiny of environmental and social performance, resulting in both opportunities and pressures for the companies involved.

### *Superannuation in Australia— Growing in size and power*

All businesses need capital to operate, and funds invested in superannuation form a huge and rapidly growing source of the capital available to Australian businesses. The amount invested in superannuation now exceeds \$497 billion, and it is growing at 9% a year. To set this in context, the capital value of all companies on the Australian Stock Exchange was about \$670 billion at the end of December 2000. By 2015, the amount of money in superannuation in Australia is predicted to increase to \$1,300 billion (\$1.3 trillion). Superannuation savings are now the second largest asset of most Australians after the family home.<sup>65, 66</sup>

There are now over 200,000 superannuation funds in Australia, but the vast majority of them are very small: 98% have fewer than five members. Total membership in all the small funds together makes up only about 1% of all super fund members (433,000 out of 23 million members) but the small funds now hold about 15% of total assets, and they are growing much faster than most types of funds.<sup>67</sup> The small funds are significant because one person may act for the fund, and so long as they fulfil their legal obligations as trustees, they can exercise their own preferences when selecting investments for the fund. They can, for example, choose to focus their investments on companies that they believe have good records of social responsibility and environmental performance.

Larger superannuation funds, with their massive asset power, can exercise influence over the environmental and social behaviour of companies, using shareholder action or direct engagement with companies, where they conclude that improvements in performance are needed.

### *Member choice of superannuation funds—Socially responsible options*

Most super funds in Australia have offered members a choice of investment for some time, that is a range of investment streams within any one superannuation fund, providing a number of products with different levels of risk and return. For some time there has been pressure to give members a wider choice: to allow them to choose the super fund they would like to belong to. Laws permitting such choice are generally expected to be adopted (through a change in federal legislation) within the next year or so.<sup>68</sup>

Most people (76%) would like to know where their superannuation is invested, according to the Resnik/KPMG study.<sup>14</sup> In other words, they think it is important to know what companies they are supporting through their super contributions.

At the present time, although superannuation funds control a majority (and growing proportion) of capital in the Australian market, most individual members of superannuation funds are largely unaware of the investment policies or the specific investments of their super funds.

As rising share ownership and other factors generate more widespread interest in the sharemarket, members' attention to superannuation fund investments is likely to rise. This means that the environmental and social views of members will create pressure on fund managers to provide options that reflect members' values. It may also mean that superannuation members recognise the potential for their fund to engage in shareholder advocacy so as to influence the actions of the companies in which they invest.

Susan Ryan, President of the Australian Institute of Superannuation Trustees (AIST), said recently that superannuation funds would offer an option of investing in a socially responsible fund if members want it. "Socially responsible investment options are member-driven. Members raise these types of issues with trustees when they get a chance. .... I believe we'll see more funds offering this type of choice if only to maintain their competitive position. There is anecdotal evidence that members are

switching funds to take advantage of ethical options ...elsewhere.<sup>769</sup>

Superannuation trustees responding to a survey in March 2001 reported that 15% of their funds currently offer members a socially responsible investment option.<sup>70</sup> (Many people in the finance sector believe that in actuality, a much smaller percentage of funds offer such an option.) In the United States most of the largest retirement funds offer such an option.<sup>71</sup>

Strong support for the right to select a socially responsible fund as a super option was evident in the results of two studies carried out in 2000. About 80% of investors between the ages of 25 and 39 and 72% of investors aged 40 to 59 said they would consider screened investments if given a choice, according to the Resnik/KPMG study.<sup>14</sup> Even a higher proportion of investors (87%) expressed the same view to researchers from Monash University.<sup>72</sup> (A screened investment was described as one that includes or excludes certain companies from the investment portfolio or fund based on the use of social and/or environmental criteria.)

Nearly all investors (92%) felt that financial performance should not be the only criterion for selecting investments. Some investors are already making choices using social responsibility criteria: 10% of respondents to the Resnik/KPMG survey reported that during the past year they had bought or sold shares based on the company's social record.

The clear implication of these results for Australian companies is that many investors are aware that some companies are much more environmentally and socially responsible than others, and they would like their investment dollars to reward the good performers. In most cases, financial return remains a prime consideration, so investors typically want to invest in companies that demonstrate good environmental and social performance as well as good financial performance.

## Rising interest in socially responsible investment

Interest in socially responsible investment (SRI) has grown dramatically over the past few years, both in Australia and overseas. This growth is reflected in the introduction of many new SRI investment funds, creation of a number of indexes based on social responsibility, such as the Dow Jones Sustainability Group Indexes and the

FTSE4Good Index, as well as a dramatic increase in the media coverage of SRI investment. Possibly even more significant are the steps taken by a number of mainstream financial analysts to add SRI criteria to their review of potential investments or their discussions with companies.

### *What makes socially responsible investment different?*

Investing that integrates social and environmental concerns into investment decisions is commonly called socially responsible investment or ethical investment. Other names for the same practice are social investing, socially aware investing and mission-based investing.<sup>73</sup>

Three different types of activities are embraced under the umbrella of socially responsible investment:

One is placement of money in managed funds, shares, bonds or other securities that are screened to reflect environmental, social or other non-financial values.

A second is shareholder action, which involves efforts to improve a company's environmental or social behaviour through exercise of rights gained as an owner of shares in the company. It may be carried out directly by individual shareholders or through investment in a managed fund that holds shares in a company and uses those shares to raise issues with the company's management. Some current issues that are the focus of shareholder action were described in Part I.

A third type of activity also commonly included in definitions of socially responsible investment is community-based investing. This typically consists of direct investments in projects or financial institutions that benefit specific communities or constituencies, especially in economically disadvantaged areas. Unlike making a donation, a community investor usually requires that, at a minimum, the original value of the investment can be returned, either by payment or trading.<sup>74</sup> This guide will not look closely at community-based investing.

### *Issues of importance to socially responsible investors*

The specific issues that concern socially responsible investors vary with time and place, but some are long-standing. Quakers have always avoided investments in weapons. Religious organisations often took care to avoid investing in alcohol, gambling, weapons, and more recently, tobacco.

A new set of issues grew out of social and environmental concerns of the 1960s and 1970: the Vietnam war, apartheid in South Africa, and an increasing awareness of environmental issues, catalysed by publication of Rachel Carson's "Silent Spring," about the danger of pesticides. Environmental issues became even stronger influences on investment in the 1980s, as a result of the Exxon Valdez oil spill, Bhopal (India) isocyanate gas leak, and ozone depletion.

Since the early 1990s, interest in global environmental issues has grown substantially, first focusing on ozone depletion and more recently on global warming. Other environmental issues, such as release of genetically modified organisms, harvesting or use of tropical hardwood, and loss of biodiversity, have also captured public attention. Social issues such as labour practices, human rights, and animal rights have also been priority concerns for many individuals and groups. Corporate governance issues may also be of interest to some socially responsible investors.

The environment is the issue of choice for Australians interested in socially responsible investment. About 83% of those surveyed wanted to invest in an environmentally screened fund, according to the Monash 1998 study.<sup>28</sup> Their prime motivations were concern for the environment (86%) and concern for future generations (81%). Commendation of a company by a well known environmental or community group would cause 58% of respondents to want to invest in that company, according to the Resnik/KPMG study.<sup>14</sup> Only 44% believed, though, that such an investment would perform better than others. The environment also emerged as the primary issue of concern in an analysis of clients' preferences by Ethical Investment Services.<sup>75</sup>

Energy efficiency was of high interest to respondents of the Monash study, with 74% indicating that investment funds should give priority to investing in this area. Among those surveyed, 83% said they would support investment in organisations demonstrating superior energy efficiency. An implicit endorsement of this finding was recently provided by Cathy Zoi, Director of Energy Technology Investments (ETI), formerly Director of the New South Wales Sustainable Energy Development Authority. In testimony before a Senate Inquiry into greenhouse issues, she related her experience in seeking venture capital for energy projects:

*"What I hear when I go around and talk to institutional investors about prospects of investing in ETI is that they are getting pressure from their members about member choice. ... My guess is that as soon as it is available, people will take it up."*

*There is an example I heard about of a listed company in the UK that does renewable energy investments. They offer no dividend for the first few years and then only modest returns compared with the stock market average, and they were oversubscribed when they listed. People want to do this. They are interested in putting their money into these areas."<sup>76</sup>*

Interestingly, despite her comment on that particular company's low returns, a US mutual fund that focuses on alternative energy investments had one of the highest returns for the year 2000 among US mutual funds in its size category.<sup>77</sup>

Other issues that are sometimes important considerations in people's choice of investment are marine pollution, woodchipping of old growth forests, uranium, and in a positive sense, renewable energy, recycling and healthcare.

### Screening for issues of concern

A fundamental aspect of socially responsible investment in shares, bonds, etc. is the use of environmental, social or other criteria to screen potential investments.

Screens can be negative, excluding certain types of investments, such as companies with poor environmental records, tobacco, gaming, etc. They can also be positive, seeking out investments in companies engaged in environmentally or socially beneficial activities, eg aiding progress to sustainability through waste management, health care, water treatment, preservation of biodiversity, etc. Positive screens can also be used in selecting for companies with good management or evidence of environmental and social responsibility. More details about how screening processes are carried out are provided in Part 4 of this guide.

Environmental and social screens are sometimes employed by managed funds that do not explicitly focus on socially responsible investment. A survey by the American Medical Association in 1996 found that about 5500 of the 7000 US mutual funds were not holding shares in tobacco companies, even though only about 60 mutual funds advertised themselves as socially or environmentally screened.<sup>73</sup>

### Women care more

Women in Australia appear to be considerably more interested than men in having their investments take into account environmental and social issues. Respondents to the Monash study were 62% women, 38% men. Men indicated less inclination to invest with social and

environmental preferences than women, and they were less concerned about environmental issues. Other issues of greater concern to women than men in the Monash study were: uranium, weapons, gambling, and biotechnology, particularly when genetically modified organisms are included.<sup>72</sup>

Ethical Investment Services analysed the demographics of its clients and found 67% women and 33% men.<sup>75</sup> HESTA, the national super fund for Health and Community Services, whose members are 86% women, was the first Australian industry super fund to offer an environmentally screened investment option.

As women now make up about 47% of direct shareowners in Australia, their environmental and social concerns will almost certainly be reflected in the investment choices they make among managed funds and individual company shares over the coming years.

### *The role of shareholder action*

As outlined in Part I, shareholder action (also called shareholder advocacy, shareholder democracy and shareholder activism) is on the rise in Australia and is a well-established part of socially responsible investment overseas. It can involve engaging in a dialogue with a company on a matter of concern and submitting and voting proxy resolutions when dialogue is unsuccessful. Both individual and institutional investors can engage in shareholder action. Shareholder advocates believe that the policies being proposed are in the best interest of all the company's stakeholders and will improve the company's reputation and performance over time.<sup>71</sup>

The Association of Superannuation Funds of Australia (ASFA) asked, in its discussion paper on socially responsible investment:

*“What role should institutional investors such as superannuation funds play in promoting wider corporate environmental and social responsibility?”*

*It is argued that it is not sound fiduciary practice for the institutional shareholder to remain passive when a company is likely to suffer financially because of consumer backlash, regulatory or legal costs or compensation payments brought on by its social/environmental practices. Cleaning up a waterway, or compensating those who bring claims of discrimination in hiring or lost sales from media exposure of sweatshop labour, all affect the company's share price performance.”<sup>78</sup>*

The CEO of the Australian Institute of Company Directors took a positive view of shareholder advocacy

in a speech on corporate governance and the need for companies to become more transparent in the way they operate:

*“Undoubtedly shareowner activism will continue to increase and should be seen positively as an essential driver of company performance and of the self-regulatory process.”<sup>79</sup>*

## **Socially responsible investment going global**

### *Socially responsible investment around the world*

Socially responsible investment is well established in the United States. One in eight dollars under management is in a socially responsible investment portfolio. In 1999, \$US2.2 trillion was invested in funds involved in socially responsible investing, including funds that undertake social and environmental screening, funds that have taken shareholder action, and funds that make community-based investments. Growth in socially responsible investment was 82% between 1997 and 1999; substantially faster than for the overall market.

Canadian socially responsible investment is second in size only to the United States. As of 30 June 2000, socially responsible investments totalled \$49.9 billion. These included: \$10.35 billion in retail investment funds, \$11.3 billion in additional assets managed by investment management firms and \$27.2 billion in assets of institutional investors.<sup>80</sup> The retail market grew by 75% between 1998 and 2000, twice as fast as the market as a whole.

Rapid growth is also occurring in the United Kingdom. Between 1994 and 2000, screened investments grew by nearly 380% from \$A1.9 billion to \$A7.2 billion. The introduction in July 2000 of disclosure requirements has spread at least some level of awareness of social responsibility in investing to all UK funds (these requirements are described in Part I of this guide).

New socially responsible investment funds are appearing with increasing frequency in a broad range of countries. Six new funds appeared last year in Spain, 20 operate in Sweden, there are several in Switzerland, and, according to *Time Europe*, “a smattering across Belgium, France and Germany.”<sup>81</sup>

Ten international social responsibility research firms, eight of them from Europe plus the well-known US firm of Kinder, Lydenberg and Domini and a Canadian firm MJRA,

have joined together to set up the SIRI Group to provide global social responsibility research. According to a recent article in *Ethical Investor* newsletter, the SIRI Group will initially release profiles of companies in Europe, the United States, Japan and Canada.

Geneva's Ethos Investment Foundation has recently published shareholder voting rights guidelines to encourage socially responsible investment. The Guidelines, described as a first in Switzerland and Europe, present the reasons underlying the voting positions for each subject commonly presented at a General Shareholders' Meeting. Ethos' fund management approach is based on long-term investment and the concept of sustainable development.<sup>82</sup>

Momentum for socially responsible investment is also rapidly building in Asia. An AsiaWeek article in April 2001<sup>83</sup> identified socially responsible investment funds in Japan, Hong Kong and Singapore. Tessa Tennant, the well-known international environmentalist formerly with Henderson Investors in the UK is heading the new non-profit Association for Sustainable and Responsible Investment in Asia (ASrIA). The Association aims to raise awareness of and promote SRI within the Asian finance and government communities.

The 20 Japanese funds are gaining great attention. Manager of the Nikko Eco Fund, Tsukushi Mizue, found that companies were "initially reluctant to answer our questions or spare the time for a meeting." But the fund collected more than \$2 billion after its launch in August 1999, and companies were knocking on its door, wanting to demonstrate their environmental consciousness and show off their "newly published environmental reports." The Nikko Eco Fund invests in such companies as Toyota, Fuji Film, and mobile phone operator NTT DoCoMo.

Singapore has had a socially responsible investment fund since 1999, Global Unifem Singapore Fund, focusing on pro-women and pro-family investments.

### *Attracting overseas investment*

Australian companies now try to attract overseas investment as well as local funds when seeking major inputs of capital. But US and UK funds focus on investments in the countries they know, often because of lack of information about overseas companies.

A financial institution in Brazil has taken a step that may merit attention by Australian companies and financial institutions. Unibanco, Brazil's fourth biggest private bank

is attempting to provide information to attract overseas investors. Clients who receive equity research from the brokerage arm of Unibanco-Uniao de Bancos Brasileiros SA have also been getting reports on the social and environmental practices of Brazilian companies ranging from steelmakers to meat packers to supermarkets.<sup>84</sup> Unibanco believes that provision of good information on environmental and social practices of Brazilian companies will attract investment.

The reaction of US investors to the Unibanco action has some clear implications for Australian companies, as indicated by the statement of Timothy Smith, senior vice president of Walden Asset Management, the SRI division of US Trust Co. "What Unibanco is doing is very important, because gathering information, whether in Spain or Brazil, is difficult," says Walden. His firm manages \$1.2 billion and has invested in emerging markets, but it employs just seven equity analysts to scout investments. "That is the great opportunity for us," says Christopher Wells, who created Unibanco's new product. "The vast majority of SRI funds are going to have to diversify. If their mission is to help the world, then they have to invest in the world."

Globalisation of the socially responsible investment industry will likely result in environmental and social information about companies in Australia and overseas becoming readily available to investors around the world.

At present, the reputations of only the largest multinational companies operating in Australia are well known to investors in the United States, Europe and Asia, but this could change rapidly in the next few years. For companies with good environmental and social performance and companies in future oriented industries, this trend could open up new opportunities for obtaining overseas capital. For companies with a poor reputation in Australia, it could mean that they face more difficulty with overseas capital acquisition than they do now.

To overcome the difficulty of Australian companies in attracting the attention of overseas investors, there will be a need for companies to ensure that they provide the types of information on their performance needed by overseas funds managers.

### *Socially responsible investment in Australia—An explosion of interest*

The early history of socially responsible investment in Australia is shown in Box 3.

In the past few years, a substantial number of socially responsible investment funds have been introduced in Australia. These new Australian funds look closely at companies' environmental and social performance and their contribution to sustainability. Westpac's Eco Share Fund was the first wholesale socially responsible investment fund and has gained considerable attention in the mainstream media since its launch in 1999. It focuses on companies' environmental performance. Westpac has since launched an international fund as well.

AMP acquired UK Henderson Investors, which has been active in the socially responsible investment field for several years with its National Provident Index (NPI) Global Care Funds, and launched three Sustainable Future Funds in Australia in March 2001<sup>85</sup>. These funds focus on sustainability and are oriented towards identifying 'Industries of the Future.'

Other notable introductions to the Australian SRI landscape have been the Dow Jones Sustainability Group Index and funds based on that index. The Index is a global ranking of companies deemed to be 'sustainability-driven.' Westpac has acquired a license to offer a fund based on the index: the wholesale Westpac International Sustainability Share Fund. More details about the Index are provided in Part 3 of this guide.

The socially responsible funds available in Australia as of July 2001 are shown in Box 4. (The list includes only funds available to the public; some religious organisations have funds whose availability is restricted.) This list is changing rapidly, with new funds being added frequently.

HESTA, the 430,000 member super fund for health and community service employees, has since 1999 offered members an option to invest in the HESTA Eco Pool created with Westpac. UniSuper has acquired some holdings in Westpac's two funds, but does not offer a separate socially responsible option to its members.<sup>87</sup> The surveys of superannuation members' interest in investing in screened funds described earlier would seem to indicate that introduction of greater opportunities for choice would lead to a substantial uptake of socially responsible funds. Several super funds have already announced that they are seriously looking at an SRI option.

Estimates of the amount of money invested in Australian socially responsible funds vary considerably, but \$1 billion to \$2 billion is commonly cited. Don Stammer, formerly chief economist of Deutsche Bank, and currently a Director of the Sustainable Investment Research Institute (SIRIS), has recently estimated that by 2020, almost \$40 billion will be placed with Australian socially responsible funds.<sup>88</sup>

### Box 3

#### Pioneers of Australian socially responsible investment

Funds based on principles of socially responsible investment (sometimes called ethical investment) have operated in Australia since the mid-1980s, but until quite recently they were regarded as occupying a tiny boutique niche in the market. That perception appears to be changing rapidly as large mainstream operators such as Westpac and AMP enter the market.

According to long-time socially responsible investment researcher Robert Rosen,<sup>86</sup> Friends Provident introduced the first prospectus-based socially responsible funds in Australia in 1986. They were hit badly by the share market crash in 1987, and for a variety of internal management reasons appeared to have floundered for a number of years after that. They were acquired by Tower in 1997.

Australian Ethical was launched as August Investments before the Friend Provident funds but prospectus approval did not come until 1989. It offers a range of socially responsible products and has grown from \$7 million in 1995 to over \$100 million in 2000. Another of the funds that has flourished since its introduction in 1994 is Hunter Hall's Value Growth Trust. In February 2001, Rosen described the Trust as the largest of the ethical funds in Australia. The YWCA Ethical Investment Trust, introduced in 1989, had success for about five years, then languished. Rosen attributes its decline to changes in investment policy and lack of support within its management company. It has been remodelled into the Challenger International Socially Responsive Fund.

Between the late 1980s and 1997 a number of funds were introduced, but made relatively little impact. Rosen attributes the slow start for socially responsive investment in Australia to ineffective marketing and the absence of a non-profit corporate research group such as the US-based Council on Economic Priorities and Investor Responsibility Research Center (IRRC), and the UK's Ethical Investment Research and Information Service (EIRIS)<sup>86</sup>.

**Box 4****Socially responsible investment funds available publicly in Australia (July 2001)\*****Australian Share Trusts**

Australian Ethical Equities Trust  
Australian Ethical Large Companies Share Trust  
Challenger Socially Responsive Investment Fund  
Equity Trustees-Australian Equities Ethical Trust  
Glebe Blue Chip Equities Trust  
Glebe Mid-Cap Equities Trust  
ING Socially Responsible Index Fund  
Tower Lighthouse Ethical Growth Trust  
AMP - Sustainable Future Australian Share Fund

**Public Offer Superannuation Funds**

Australian Ethical Superannuation Funds  
ANA Ethical Superannuation Fund  
Freedom of Choice Super Masterfund  
HESTA Eco Pool  
Tower Ethical Growth Funds  
Trust Company Members Masterfund

**Multi-Sector Balanced Trusts**

Australian Ethical Balanced Trust  
Glebe Broad Spread Investment Trust  
AMP- Balanced Growth Fund

**International Share Trusts**

Glebe Pan-Asian Growth Trust  
Hunter Hall Value Growth Trust‡  
AMP- Sustainable Future International Share Fund

**Wholesale Funds**

AMP Sustainable Future Funds†  
BNP Ethical Fund  
BT Ethical Balanced Fund (formerly the BT Australia Charities Trust)  
IOOF Socially Responsive Shares Trust  
Rothschild Ethical Conservative Trust (formerly the Charities Wholesale Trust)  
Rothschild Ethical Share Trust  
Warakirri Australian Equities Charities Trust  
Westpac Australian Eco Share Fund  
Westpac International Sustainability Share Fund

**Liquid/Interest Bearing Investments**

Australian Ethical Income Trust  
Bendigo Bank/CAA Ethical Investment Account  
Glebe High Grade Fixed Interest  
Glebe High-Grade Fixed Interest Trust  
Maleny Credit Union  
Sirius Community Finance

**Insurance Bonds**

Foresters ANA Ethical Investment Insurance Bond  
Tower Ethical Growth Bond

\* Source: Corporate Monitor

† These funds are also available on a retail basis (see under Australian Share Trusts, Multi-Sector Balanced Trusts, and International Share Trusts).

‡ Includes 30% Australian shares

Some of the very large US firms specialising in socially responsible investment appear interested in entering the Australian market, if they can cut through existing regulatory hurdles. The long experience and credibility of some of these firms seem likely to attract interest if they develop Australian socially responsible investment products that include industry sectors not well represented here.<sup>89</sup>

## Performance of socially responsible investments

The evidence for good financial performance of firms with sound environmental and social management was described in Part I. Funds made up of environmentally and socially responsible companies should therefore also produce good financial returns.

Despite the growing interest in socially responsible investment, perception is still widespread though that such investment represents a triumph of environmental and social concern over sound financial sense. In 2000, 44% of people surveyed in the Resnik/KPMG study thought a socially responsible fund would not perform as well as a more mainstream fund.<sup>14</sup> Many Australian companies regard socially responsible investment as irrelevant, assuming that it only appeals to the dedicated few who are not very interested in financial return.

Evidence is accumulating, though, that socially responsible investment does not carry a financial penalty: some of the funds have performed far better than the market as a whole, and on average, return is comparable to other types of funds.

The recently launched *Ethical Investor* magazine publishes monthly reports of the performance of each socially responsible investment fund based on research by Corporate Monitor.<sup>90</sup>

The socially responsible investment market in Australia is too new and still too small to provide authoritative evidence of long-term performance, but Tower Lighthouse Ethical Growth Trust, Tower Ethical Growth Fund, Australian Ethical and the Hunter Hall Value Growth Trust have performed extremely well over the past decade. Westpac has calculated that its Australian Eco Share Fund would have outperformed the All Ordinaries Index over the past 10 years.<sup>91</sup>

Evidence from the United States is much more definitive. US-based Domini Social Index, which was established in

1990, tracks the performance of 400 socially screened companies. Returns over that period have outperformed the traditional Standard and Poors (S&P) 500 Index. Another US index of screened companies, the Citizens Index, which measures the performance of 300 screened companies, has also performed better than the S&P 500 Index.

The ASFA Discussion Paper on Ethical Investment<sup>78</sup> quotes UK investment firm Henderson Global Investors (part of AMP) on the rationale for good long-term performance by socially responsible investments:

*“SRI takes as its thesis the acceptance that certain key socio-economic trends will fundamentally shape future economic and corporate activity. These trends are broadly categorised by the terms ‘sustainability’ and ‘socially responsible’. Companies attuned to, or aligned with, these concepts are likely to demonstrate superior financial and hence share price performance in the future.*

*...SRI [is] investment in companies which will contribute to, benefit from or best adapt to the global shift to environmentally and socially sustainable economic activity. These companies are less likely to have their share price affected by environmental remediation (clean up), litigation and compensation payments. They may be more viable in the long term.”*

Performance ratings of US socially responsible mutual (managed) funds by the mainstream Morningstar and Lipper research houses gave top ratings to over 70% of the largest funds. The Director of the Social Investment Forum in the US declared, “the numbers don’t lie. The underperformance myth has been busted. Even during a period of serious market volatility, on average socially screened funds of all types continue to equal or exceed the performance of non-screened funds.”<sup>71</sup>

In a similar vein, Alisa Gravitz, executive director of Co-op America, a non-profit investor education organization, commented: “We are now rapidly approaching the day when socially and environmentally responsible investing will be a ‘no-brainer’ for millions of additional investors. When you have excellent performance in both up and down markets and increasing opportunities to make this world a better place to live, the case for screened funds is extraordinarily powerful.”<sup>71</sup>

A commonly held view among financial analysts is that any reduction in the universe from which an investor may select stocks or bonds for a portfolio produces ‘opportunity costs’ that will lower return. For years, such analysts have argued against social and environmental screening, suggesting that such screens create risk and/or harm financial performance.<sup>92</sup>

Over the past decade, however, a growing number of research studies of screened portfolios have shown that the performance of screened portfolios does not result in lower returns. A 1997 study by John B. Guerard found there to be “no statistically significant difference between the average returns of a socially screened and an unscreened universe during the 1987-1996 period.” His study compared a screened universe of 950 companies and an unscreened universe of 1300 companies for the period 1987 to 1996.<sup>93</sup> Other researchers, including D’Antonio et al<sup>94</sup> and Diltz,<sup>95</sup> obtained similar results.

Despite the evidence, many financial analysts still remain sceptical about socially responsible investment. The language of eco-efficiency, environmental management systems, and emissions is outside their normal terms of reference. There are no familiar balance sheets for them to compare on environmental or social performance (although that is changing). At the first conference of the Ethical Investment Association in August 2000, one analyst declared, “if they [socially responsible funds] don’t perform any better than conventional funds, why should we recommend them?”<sup>96</sup> An investor interested in environmental and social responsibility, on the other hand, might be more inclined to ask: “If they don’t perform any worse than conventional investments and they are better on environmental and social performance, why shouldn’t everybody want to invest in them?”

## Conclusion to Part 2

Australian companies will increasingly be faced by both the opportunities and risks presented by the massive growth in superannuation funds and the rapid expansion of shareownership. Current and potential investors are making it clear that they think environmental and social issues should be taken into account, alongside financial return, in making investments. Companies that can attract such investors will benefit; others will have difficulty in surviving.

Although socially responsible investment analysts were the first to pay careful attention to the environmental and social performance of companies, this trend is spreading to larger mainstream financial institutions. With growing importance placed on environmental and social issues, and recognition of the risks associated with poor performance, inevitably, all serious investors will eventually have to consider such issues, along with financial performance, when making investment decisions.

## PART 3— Attracting 21st Century Investors

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Companies that need to attract external capital want to be attractive to as wide a spectrum of the market as possible. But the view that a company has of its own performance may be different from the way it is seen by others. Companies will therefore find it critical to understand both how potential investors assess company performance and the steps that the company itself must take to demonstrate that it is a desirable investment.

Part 3 covers the following topics:

- the criteria socially responsible investors and investment funds apply in selecting companies for investment
- the methods used by socially responsible investment researchers in evaluating and comparing the performance of different companies

### What are today's investors looking for?

All investors, whether individuals or funds, use some selection criteria to choose companies from the universe available. The prime criterion has been, and continues to be, financial performance of the company. Investors in managed funds or shares are looking for an increase in value of their investment, and may also be concerned about other financial attributes, such as effect on tax, amount paid in dividends, etc.

Many investors apply criteria beyond just financial performance. They want to feel that their investments are consistent with their values and interests. The growth of socially responsible investment indicates that an increasing number of investors want to encourage companies to protect the environment and act in a socially responsible manner. Many want to promote the development of products, processes and approaches that contribute to sustainability.

The application of criteria to selection of investments is commonly referred to as screening, but it merely means selection. Selection criteria, or screens, provide the basis for deciding what types of investments or companies are considered, not considered at all, chosen now, or deferred for later re-consideration, as well as how much of particular investments are purchased or sold at different times.

Socially responsible investors and investment funds may apply any of a wide range of different techniques in selecting companies for investment. These include use of negative and/or positive screens, determination of the best company in each business sector, or use of an index.

Recently some investment firms have begun using SRI criteria to guide their engagement with companies – traditional selection techniques are used to choose companies, but discussions are held with the companies about environmental, social and corporate governance issues of concern.

#### *Negative screens—Avoiding some types of investments*

The earliest socially responsible investments were strongly driven by a desire to rule out investments in certain types of activities. Religious institutions often wanted to exclude investment in alcohol, gambling, tobacco, and, for some, companies involved in weapons production or other war-related industries. A key exclusion used between the 1970s and early 1990s was investment in companies that did business in South Africa.

The environment is probably the most common issue used for screening in Australia, and it is the fastest growing area of screening in the United States. The US-based Social Investment Forum says that environmental considerations are now used in 79% of screened investment strategies.<sup>71</sup>

The range of exclusionary screens applied by investors today has expanded to several hundred. Any one fund or institutional investor does not, of course, simultaneously apply all of them. EIRIS, the UK-based non-profit investment research organisation, uses 330 different criteria in 30 different categories.<sup>97</sup> Some of the environmental categories they use are: animal testing, greenhouse gas emissions, health and safety breaches,

nuclear power, ozone depletion, marketing of pesticide products, road-building, extraction, sale or use of tropical hardwood, and involvement in water pollution incidents. Some negative screens may involve thresholds, such as “firms that derive more than 2% of their gross revenues from the sale of military weapons.”<sup>98</sup>

### Some Australian SRI funds apply negative screens

The Rothschild ethical funds introduced to Australia in April 2001 apply negative screens for gaming, alcohol and tobacco, uranium, weapons, and companies with poor environmental and/or human rights records.<sup>99</sup>

Australian Ethical investments are governed by a Charter that includes 11 negative screens, and 12 positive screens.<sup>100</sup>

### Positive screens—Preferences for some activities/characteristics

Some of the positive screens EIRIS uses are: provision of ‘positive’ products or services, such as pollution control, healthcare, education industries; community involvement; disclosure; grading of a company’s environmental policies, reports, and management systems; good records on equal opportunities; and grading of retailers and food manufacturers’ policies on foods containing genetically modified organisms.<sup>97</sup>

### Using a positive screen

AMP’s Sustainable Future Funds, launched in Australia in March 2000, assess companies within the context of corporate social responsibility and focus on “companies that will form part of a socially and environmentally sustainable future. Typically, these ‘Industries of the Future’ include health care, transport, renewable energy, education, water management and recycling.” These funds also make use of the common negative screens.<sup>101</sup>

Positive screening can also be used to give priority to companies with good performance. The Socially Responsive Investment Fund offered in Australia by Challenger International evaluates companies on the basis of what it calls a “socially responsive leadership analysis,” which emphasises leadership, with respect to specific social criteria. The criteria include environmental impact and management, corporate and workplace practices, philanthropy, good corporate citizenship, human rights, and ethical and responsible product development, testing, distribution and design.<sup>102</sup>

### Cochlear—improving the quality of life for thousands worldwide

For the deaf and hard of hearing, a cochlear implant can literally change their lives. Cochlear Limited, which grew out of pioneering research at the University of Melbourne, is today operating throughout the world, and its research involves collaboration between universities in Australia, the United States and Germany.

To remain a world leader in its field, new and improved products are being introduced on a regular basis. The company’s business success has to date reflected the wide acceptance of its products.

Cochlear products have received awards for design and medical innovation in Australia and overseas.

For additional information see [www.cochlear.com](http://www.cochlear.com)

### Best-of-sector screening—selecting leading firms in every business sector

Investment funds typically spread their investments across the range of business sectors, ie chemicals, media, banks, etc. Many investors, particularly large institutional investors like superannuation funds, hold concerns that use of screens increases financial risk, through narrowing the range of companies and sectors available for investment. By taking an approach that no sectors will be excluded, an investment portfolio closely matches the profile of the overall share market, so its level of risk should closely match that of the whole market.

Using a best of sector approach, as is employed in the Westpac Australian Eco Share Fund, companies are judged against a defined set of criteria. The firms that emerge best from this analysis are considered appropriate for investment, assuming that they are also found to be acceptable in financial terms.

As was discussed in Part 2, a number of studies have shown that there is no significant difference in the financial performance of funds screened for social responsibility (including funds using negative screens) and unscreened ones. This is not at all the same as saying that the risk levels are equal; risk levels measure things like volatility (how much variation occurs in price) or tracking error (how much the performance of the fund differs from, say, the All Ordinaries Index). Higher risk funds can produce returns that are better or worse than the average. Many cautious fund trustees and managers consider that the safest course is to produce returns that match the market average.

## Constructive engagement

A trend becoming particularly evident in the UK is the development of managed funds invested along traditional financial lines, but committed to 'corporate engagement.' These funds take account of sensitive issues by means of what they call an overlay, ie it doesn't affect the investment selection process, but social and environmental concerns are identified. Fund managers follow up on these issues of concern by meeting with companies to encourage the adoption of more socially responsible behaviour. The investment fund may also join other shareholders to submit resolutions to company meetings and may vote against adopting annual reports if coverage of environmental and social issues is inadequate.

The emergence of these funds is, in part, a response to the disclosure provisions required of UK pension funds since 2000.<sup>103</sup> The requirement for disclosure has led a number of large mainstream investment management firms, superannuation funds and insurance companies to include examination of social and environmental issues across their entire portfolios.

Friends Provident (UK) said that initially its 'responsible engagement overlay' (REO) would focus on four issues: environmental management, climate change, human rights, and labour standards. Keith Satchell, CEO of Friends Provident described the objective of 'engagement' as improved financial performance, so shareholders would benefit.

*"Good corporate practice on human rights, child labour and environmental pollution is good for society but it's also good for shareholders," he said. "It is right that we use our influence to encourage responsible business practices while serving the financial interests of our customers."*<sup>104</sup>

In Australia, the \$10.4 billion Commonwealth Superannuation Scheme/Public Sector Super (CSS/PSS) announced in June 2001 that it would adopt a constructive engagement approach covering the entire fund, because it is legally unable to offer members an SRI option. Under the approach adopted, an external firm will engage in a dialogue with companies held by the whole fund, with the aim of improving environmental and social performance. This approach relies on the power of the large investor to convince companies that it is in their best interest to address matters raised as being of concern. Such matters could relate to environmental, social or corporate governance issues.

About one-third of the capital controlled by investors who are engaged in shareholder advocacy in the United

States is held by institutional investors that use both screens and advocacy,<sup>71</sup> and two-thirds is controlled by institutional investors that are actively involved in shareholder advocacy but do not use social or environmental screens for their investments. The latter type of fund uses constructive engagement with companies as a means of bringing about changes in behaviour.

Craig Mackenzie, Director of Socially Responsible Investment at UK investment firm Friends, Ivory & Sime, says, "Engagement is more constructive than screening. Avoiding investing in nasty companies does not make them change."

## Using an index of environmentally and socially responsible companies

A stock market index, such as the Standard & Poor's 500 or the Russell 2000, is a market capitalization-weighted portfolio of stocks. All stock market indexes attempt to reflect the behaviour of the market or some sub-set of it, such as small companies.

A number of indexes of socially responsible companies have been constructed over the past decade. One of the longest running of these indexes is the Domini 400 Social Index (DSI) in the United States. It tracks the performance of 400 companies that pass multiple, broad-based environmental and social screens. It attempts to reflect the behaviour of stocks of companies that the socially responsible investor might purchase.

A substantial number of investment funds are based on portfolios that are reduced-scale versions of a major share index. A portfolio may consist of, for example, one share for every 1000 shares on the Australian S&P 200 Index. The fund normally holds shares in every company in the index, and the proportion of total fund holdings in each company matches that on the index.

The Dow Jones Company, whose Dow Jones Industrial Index is the most frequently cited indicator of activity on US sharemarkets, joined in 1999 with a Swiss company, SAM Sustainability Group, to create the Dow Jones Global Sustainability Index family. The index is made up of companies selected as being in the top 10% of 'sustainability companies' worldwide.

The developers of the index apply a set of criteria to determine which companies should be included. The family of indexes include a cluster for each of five geographical areas. Within each area there are four

indexes that use different negative screens: excluding alcohol, excluding tobacco, excluding gambling, and excluding all three. All indexes exclude companies that have 50% or more of their sales in military weapons.

Westpac has created the Westpac International Sustainability Share Fund (WISSF) of international shares, based on the Dow Jones Sustainability Group Index. HESTA super fund offers members an Eco Pool option with 40% of its holdings in WISSF. Eco Pool also holds 40% Australian shares, through investment in Westpac's Australian Eco Share Fund.

## How companies are evaluated

The process Australian socially responsible investment funds use to evaluate companies involves examination of information from several sources. Companies are generally asked to fill in detailed questionnaires about their activities, and publicly available data on the companies is also obtained. CERES, which is the main organisation behind the Global Reporting Initiative, has a 35-page questionnaire for companies to complete.

Research on companies is carried out either by an in-house or an external investment research group, depending on the fund. A number of SRI research firms have been formed in Australia over the past couple of years. Investment research groups make their analyses of companies available to their clients.

Investment research firms in Australia have ready access to much less information than their counterparts in the United States and in some other overseas countries. Requirements for public disclosure of company information are much more extensive in some places overseas than in Australia. In addition, overseas NGOs publish a considerable amount of information about companies' activities on the Internet. As a consequence, research firms and investors in Australia sometimes have to make judgements about the social responsibility of companies based on considerably less information than they might like to have.

Low-cost research services for individual investors are provided by Business Ethics Research Centre ([www.berc.com.au](http://www.berc.com.au)) and Integrative Strategies.

[www.integrativestrategies.com.au](http://www.integrativestrategies.com.au)

### Company profiles

Research firms in the socially responsible investment field take varying approaches to the evaluation of companies.

Sustainable Investment Research Institute (SIRIS) develops profiles of companies and investment universes.<sup>105</sup> It creates sustainability profiles of companies, describing their performance on the key issues, opportunities and risks associated with the company's operations. A profile is developed from information provided by the company in response to a questionnaire; from publicly available records, such as EPA information on violations, National Pollutant Inventory, and media reports; and from meetings and other dialogue held with the company.

Their research is focused on five issue areas:

- environmental aspects and impacts
- product quality and stewardship
- workplace practices
- corporate governance and ethics
- regulatory compliance

Once it has developed a profile, SIRIS liaises with the company profiled to determine whether all information included is accurate.

### Company rating

Monash Sustainability Enterprises (MSE) obtains information in a similar manner to that described above. It uses a questionnaire sent out to companies, public records, media coverage and interviews. The form of assessment is, however, different from that of SIRIS. MSE's environmental performance framework incorporates: ecological footprints, environmental risk, best practice environmental management, business innovation, and eco-communication. These factors are assessed in terms of a company's strategy, management, operations, products, and stakeholder relations.

MSE assigns each company a numerical score and rating based on the information gathered. After rating the companies, MSE ranks them from 1 to 6 within each industry sector. The basis of the ratings is shown in Box 5.<sup>106</sup>

Dow Jones Sustainability Group Indexes also rank companies within industry groups. The basis of their ratings are different from those described above. They look at economic, environmental and social opportunities and risks. Within each of those it assesses a company's strategic approach, management and performance on industry specific issues.<sup>107</sup>

## Box 5

### Performance benchmarks applied by Monash Sustainability Enterprises in evaluating companies

#### Superior

- industry best practice for its industry sector
- sustainable development practices integrated into strategy and policies and backed by an EMS integrated into decision making
- striving to ensure that operations, products, and services are sustainable; environmental impacts are declining
- high priority given to stakeholder relations; demonstrated by meaningful consultation and disclosure of environmental performance information

#### Responsive

- environmental management is a high priority in company's business strategy and policies; commitment to go beyond compliance; management systems near completion/ integration
- major environmental impacts systematically tracked; programs in place to reduce impacts
- engaging stakeholders directly affected by operations, provides comprehensive information, factors stakeholder concerns into plans and activities

#### Emergent

- the environment is not yet seen as a strategic business issue; policy and management systems beginning to be developed
- typically compliance-oriented; environmental management systems not integrated with business management processes
- systematic programs to minimise environmental impact not yet in place; significant environmental impacts may have been identified
- public trust recognised as important issue; emphasis tends toward management of stakeholders rather than meaningful engagement

#### Nascent

- either a lack of recognition of environmental issues at the strategic level or company strategy does not reflect public expectations
- effectiveness of environmental management systems, where they exist, limited: environmental impact not being adequately addressed, or present activities have unacceptable levels of environmental risk

*Ethical Investor* magazine publishes monthly ratings of the SRI performance of Australian listed companies based on research by Corporate Monitor. The ratings cover environmental, social and governance performance.<sup>90</sup> The magazine also lists the companies held by each of the SRI funds.

The approaches to evaluation shown here represent a sampling of the techniques in use by Australian SRI researchers. Each research group uses its own method, and these methods may differ somewhat from the ones described in this guide.

### *Assessment of overseas operations*

A number of high profile companies have had major problems in their overseas operations attracting a great deal of adverse media coverage. Issues involving Australian companies' overseas activities have most often related to environmental performance, but some companies have also been criticised for actions involving human rights, labour practices, and other issues.

When researchers in Australia review companies, they deal primarily with local sources of information and local company staff. Since overseas operations may be

conducted by subsidiary or affiliate companies, local Australian sources may have little information on the overseas operations. This may create somewhat of a challenge for researchers attempting to evaluate social responsibility of a company.

Although information on overseas operations of Australian companies has been difficult to obtain locally, such operations may be assessed by investment research organisations in the country of operations or in the United States or United Kingdom. Socially responsible investment research has been conducted in the US and UK for over 25 years, and some of the large non-profit independent research organisations have assembled massive databases on companies. (Their data may also include details of Australian operations.)

Large commercial investor research firms in the United States, such as Kinder, Lydenberg, and Domini and Innovest Strategic Value Advisers also have accumulated a wealth of material on hundreds of companies.

Australian research firms and investment funds can subscribe to the information services provided by the overseas firms and thereby obtain details of the overseas activities of companies operating in Australia. It may therefore be useful to Australian companies to be aware of the type of research information produced by these overseas firms, some of which is posted on the websites of these organisations.

As an example, the information in Box 6 lists the environmental analyses carried out by the Investor Responsibility Research Center (IRRC). In addition to these analyses, their examination of a company also looks at the company's social issues, human rights, corporate governance, workplace issues, involvement in nuclear power, and animal testing.

The growth of global networks for socially responsible investing will clearly mean that companies' performance overseas will be scrutinised as closely as their activities in Australia.

### *Use of metrics in company evaluation*

Investment funds usually try to base their company evaluations on criteria that are "systematically ascertainable, quantifiable, and significant."<sup>109</sup> Systematically ascertainable means that the information is verifiable, either with or without a company's assistance. Examples are the level of a pollutant emitted to air and the number of violations of a company's EPA license conditions.

Good indicators exist for the measurement of many aspects of environmental performance. These are readily available in documents on public environmental reporting, such as those by Environment Australia and the Global Reporting Initiative (see Part 5).

Quantifying management, leadership, contribution to sustainability, and many aspects of social performance is more difficult. The Global Environmental Management Initiative (GEMI) held a conference on social metrics in March 2000 at which presenters identified metrics for a wide range of social issues.<sup>110</sup> Some of the indicators proposed could be readily applied, others would suffer from an inability to obtain reliable data, and still others could be seen as too subjective to be useful. A great deal of additional work will be needed to develop fully adequate metrics for evaluating companies' social performance and other important aspects of corporate social responsibility.

## **Conclusion to Part 3**

Investors, whether individuals, managed funds, or organisations, increasingly are interested in more than just financial information about companies. Some investors want to ensure that the companies in which they invest perform in a manner that is consistent with their own values. Awareness is also growing that environmental and social factors have significant financial implications, so many more investors are starting to look at such issues.

Socially responsible investors vary somewhat in the specific issues given priority in company selection, and their researchers may use varying techniques for in evaluating companies. To attract investors, it is important for companies to be aware of what criteria are used for selection and how evaluations are performed. That awareness can help companies ensure that they provide investment researchers with the information that they need to make informed decisions about potential investments.

## Box 6

### Environmental profile—Investor Responsibility Research Center, Washington DC<sup>108</sup>

(An example of the type of analysis carried out by some overseas SRI research firms)

<p><b>Section 1 Company introduction</b></p> <p>Company introductory materials</p>	<ul style="list-style-type: none"> <li>• description of company activities</li> <li>• environmental disclosures on expenditure and liabilities</li> <li>• other legal proceedings</li> </ul>
<p><b>Section 2 Quantitative Government Data</b></p> <p>Hazardous waste cleanup responsibilities</p> <p>Permit restrictions</p> <p>Toxic chemicals</p> <p>Reported spills</p> <p>Compliance data</p>	<ul style="list-style-type: none"> <li>• Superfund National Priority List sites</li> <li>• corrective actions required</li> <li>• performance trends over several years</li> <li>• permit denials</li> <li>• facility shutdowns ordered</li> <li>• performance trends over several years</li> <li>• transfers and releases</li> <li>• total production waste</li> <li>• energy release and recovery</li> <li>• production waste generation</li> <li>• emission trends over several years</li> <li>• production waste trends over several years</li> <li>• oil spills greater than 10,000 gallons</li> <li>• chemical spills greater than 10,000 pounds</li> <li>• spill trends over several years</li> <li>• compliance with 9 different statutes</li> <li>• penalties</li> <li>• total value of penalties</li> <li>• penalty trends over several years</li> </ul>
<p><b>Section 3 Company Survey Data</b></p> <p>Company survey data</p> <p>Achievements and objectives</p>	<ul style="list-style-type: none"> <li>• organisation and management</li> <li>• reporting structure for senior environmental officer</li> <li>• environmental staff</li> <li>• Board committee for environmental matters</li> <li>• primary issues being considered by Board committee</li> <li>• public statements</li> <li>• environment considered in management compensation</li> <li>• participation in EPA voluntary initiatives</li> <li>• percent of waste recycled-hazardous and non hazardous</li> <li>• lifecycle product development/process design</li> <li>• lifecycle assessment (LCA) integration in design</li> <li>• evaluation of lifecycle impacts</li> <li>• technology redesign</li> <li>• emission reductions by 8 types of emissions: air, water, hazardous waste, non-hazardous waste, VOCs, ozone-depleting substances, CO<sub>2</sub>, other</li> <li>• methods of reduction</li> <li>• underground storage tanks removed or replaced</li> <li>• environmental training</li> <li>• 3 most important environmental accomplishments in year</li> </ul>

## Box 6 (continued)

Achievements and objectives	<ul style="list-style-type: none"> <li>• most important environmental projects</li> <li>• total site remediation costs</li> </ul>
Risk management and reporting (all industries)	<ul style="list-style-type: none"> <li>• evaluation of risk in selecting suppliers, contractors, etc; also whether this applies internationally</li> <li>• environmental insurance</li> <li>• top 3 suppliers</li> <li>• charters, codes or voluntary initiatives</li> <li>• separate public environmental report: date first published; frequency; most recent report</li> <li>• sustainability report published</li> <li>• policies and practices for dealing with stakeholders</li> </ul>
Policies and reporting (manufacturing/industrial)	<ul style="list-style-type: none"> <li>• standards as stringent as US law</li> <li>• ISO 14001 certification</li> <li>• other EMS programs</li> <li>• benefits from ISO 14001</li> <li>• internal metrics developed/tracked</li> </ul>
Environmental compliance auditing (for manufacturing and industrial companies)	<ul style="list-style-type: none"> <li>• auditing program</li> <li>• average time between audits</li> <li>• audited in last two years</li> <li>• how auditors selected</li> <li>• audit results</li> </ul>
Lending and investment practices (service and financial companies)	<ul style="list-style-type: none"> <li>• brownfields redevelopment</li> <li>• lending policy/guidelines US, non-US; due diligence required before purchasing property; before lending funds</li> <li>• who conducts lending assessments</li> <li>• non-US direct/indirect investment by region; projects</li> <li>• types of projects outside US</li> <li>• non-US investment uses guidelines from independent organisation</li> <li>• is single standard applied to all non-US investments</li> <li>• standard as stringent as US law</li> <li>• company monitoring of lending guidelines once funds allocated</li> <li>• who monitors?</li> <li>• frequency of monitoring</li> <li>• environmental screens used on investment</li> <li>• environmentally oriented investment products or services</li> </ul>
Sustainability development indicators	<ul style="list-style-type: none"> <li>• company use of energy, water, raw materials, recycled materials, and generation of hazardous waste; change from previous 10 years</li> <li>• breakdown of sales by country</li> </ul>
Additional issues	<ul style="list-style-type: none"> <li>• company view of value of positive environmental performance</li> <li>• most important company sectors by revenue</li> <li>• activities outsourced</li> <li>• paper consumed per capita</li> <li>• changes created by use of indicators and internal metrics</li> <li>• audit compliance level variation by division</li> <li>• environmental experts consulted in assessing environmental risk</li> </ul>
Section 4 News Bibliography	
Section 5 Company Comments	

## PART 4— Demonstrating Good Environmental and Social Performance

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For Australian companies to attract socially responsible investment, they have to match up to the criteria investors consider important. Previous sections of this guide described how researchers for socially responsible investors evaluate a company's performance. This section identifies a number of the elements that would help a company demonstrate that it is socially and environmentally responsible.

Meeting the current expectations of investors and other stakeholders means conducting the company's activities in an environmentally and socially responsible manner, and communicating with stakeholders so that they have the information they want and need.

Part 4 covers the following topics:

- taking stock of where you are now
- communicating where you are
- evaluating strategic directions
- implementing appropriate changes

Environmental and social issues facing business vary with the nature of the company's activities. In the following sections, some issues are specified for particular types of companies. Others apply to all companies. They provide some suggestions on how your company can improve its environmental and social performance.

### Taking stock of where you are now

Before a company can even begin to develop a strategy for making changes to become more environmentally and socially responsible, it has to obtain a clear picture of its starting place. Some indication of how your company is viewed may be provided by your honest answers to a few questions posed by Attracta Lagan of KPMG.<sup>111</sup>

- Who are three of your primary stakeholders? What is your impact on them?
- How would they rate your performance in the social, environmental and ethical arenas? How is this communicated?
- What is your company's vision for its relationship with local and national communities?
- How does your company's environmental impact compare with peers?
- What is your company's social footprint and how does it compare with peers?
- Identify the positive values surrounding your company or brand name.
- What do your employees say about your company? Would you recommend it as an employer of choice for your children?

One helpful aid to self-assessment might be the relatively short but insightful series of questions produced by a UK business group, the Advisory Committee on Business and the Environment, under the title of *Value, Growth Success-How sustainable is your business*. For each of the questions, it shows you some responses you can derive confidence from, and some you should be concerned about. The briefing note is available for downloading from:

[www.defra.gov.uk/environment/acbe/directors/pdf/director.pdf](http://www.defra.gov.uk/environment/acbe/directors/pdf/director.pdf)

You can also obtain the questionnaires used by investment research firms for evaluating companies. These are described in the previous section of this guide. If you fill out a questionnaire, assess your results as objectively as possible, and look on the Internet for articles about your company, you should be able to get some picture of how researchers and potential investors may rate your company.

### Environmental issues

The environment is the key issue on which Australian investors in socially responsible investment funds most frequently judge the social responsibility of companies. In addition, environmental issues are of increasing concern

to lenders because of the financial risks associated with current, past, and even future activities of companies. The rise of shareholder action is also drawing prominent public attention to company activities.

Large resource-based and manufacturing companies face somewhat different issues from those affecting companies whose activities are office-based, service oriented, or in retail sales. All companies, though, are receiving increased scrutiny from the public and the financial community with respect to their environmental performance.

### *Environmental issues for all businesses*

It is important for businesses to give careful consideration to the significant environmental issues of the 21st century. Clearly one of the most important issues will be the need to reduce use of material resources and energy while maintaining quality of life in developed countries and improving life in developing countries. The necessity of reducing greenhouse gas emissions will be one of the drivers for addressing this issue.

Energy has definitely become an environmental issue. Some investment research firms are now assessing the risk to companies from changes in national and international policies on climate change. Innovest, a US investment advisory firm, is carrying out analyses of the financial implications of climate change for specific companies.<sup>112</sup> It benchmarks companies relative to regional and industry benchmarks on emissions profiles, financial exposure, and the company's climate change strategy. The range of issues covered by their analysis includes:

- greenhouse gas emissions (in relation to sales and production)
- change in emissions since 1990
- implication of Kyoto target of the country of operation
- company's policy, strategy and public statements
- mitigation and innovation measures
- benchmarking of carbon efficiency performance
- direct carbon risk from in-house operations and emissions
- benchmarking of exposure to CO<sub>2</sub>-related market risks

- carbon market risk embedded in offered products and services
- carbon related profit opportunities
- emissions trading

Australians rank air and water pollution high on their list of environmental concerns. Reduction of air pollution will affect large industrial users, but it also has implications for every business because transport of supplies, products and employees is a major air pollution source (as well as a large contributor to greenhouse gas emissions). Water pollution is not only an issue for manufacturers and resource-based companies, but also for companies whose properties can produce substantial amounts of stormwater runoff. Salinity will significantly affect a number of Australian companies as its spread intensifies across many areas of the country.

### *Public environmental reporting*

Public environmental reporting is one of the most important elements of environmental performance used by investors and other stakeholders use to judge a company's social responsibility. The basic determination is whether a company prepares a public environmental report at all, either as a stand-alone document or as a part of the company's annual report. The next basis for judgement is the quality of the report itself. Typical indicators for evaluating environmental reports include:

- external verification
- environmental policy
- environmental and social performance
- data
- compliance
- stakeholder and community participation
- environmental performance targets
- format, dissemination and feedback<sup>40</sup>

### *Working co-operatively with environmental organisations*

Environmental organisations are, in many cases, adopting new approaches in their dealings with industry. In the past, typically, the organisations reacted to environmental issues raised by business developments or proposals. More recently, environmental groups also have worked

with industry to achieve mutually beneficial results. The WWF program for evaluating public environmental reports has been aimed at assisting companies to improve their communications.

The Total Environment Centre in Sydney, with input from other environment groups, has been developing tools for evaluating companies' environmental performance. The tools will involve self-assessment by a company backed up independent random audits by a team involving environmental NGOs in partnership with others having technical and economic expertise.<sup>113</sup>

### *Environmental issues—For industrial and resource-based companies*

If your company is engaged in large-scale manufacturing or a resource-based industry, you have almost certainly had to address environmental issues as a normal part of your operations for many years. Environmental issues are high on the agenda of concerns that most people have about the operation of companies. And as environmental concerns become more prominent in the

financial and wider community, the expectations about your company's environmental performance are increasing.

To gain a clearer picture of how your company measures up in its environmental and social performance you can carry out a stocktaking exercise. You may want to start internally at first, but to gain a complete picture you will have to involve some of your key stakeholders. (If you are not actively communicating with those key stakeholders, you have already identified one area that needs attention.)

You already know about ISO 14001 and have probably developed an environmental management system. You know about public environmental reporting, and produce a report or are thinking seriously about one. You know your license conditions and are complying with them or are working closely with the EPA or other agency to resolve outstanding problems. But these days, you are expected to do more. If you don't, you will lose out to competitors whose thinking is more far-reaching.

### **AGL takes a triple bottom line approach to its Ballera to Mt Isa natural gas pipeline**

The Ballera to Mt Isa natural gas pipeline, constructed for the Australian Gas Light Company (AGL), conveys natural gas from reserves in southwest Queensland to the north west of the state. The pipeline was initially constructed to supply fuel for the Mica Creek Power Station at Mt Isa, but now also provides fuel to other developments in the area, such as BHP's Osborne and Cannington mines.

The route chosen for the pipeline was critical in determining its cost and its environmental and social impacts. AGL was able to minimise all three by taking a strategic approach to determining the best route, based on an extensive consultation and public participation process.

Some examples of AGL's triple bottom line achievement with the Ballera to Mt Isa pipeline project include:

- pipeline construction was completed ahead of schedule and well within budget;
- active participation of Aboriginal groups and individuals resulted in the identification of previously unrecorded cultural heritage sites along the pipeline's easement, which were preserved by "zig-zagging" the pipeline around these sensitive areas;
- disturbance of a colony of bilbies, a threatened species, was avoided through the careful planning of the pipeline's right of way, after extensive consultation with leading bilby experts.

The pipeline now delivers natural gas to Mt Isa, replacing more polluting coal and oil. This results in on-going greenhouse gas emission reductions and local air quality benefits. AGL's success with the project has been recognised with an environment award from Keep Australia Beautiful.

For further information on AGL's community relations and environment programs, see <http://www.agl.com.au/about/default.asp>

Case study from Towards Sustainable Development ,  
Business Council of Australia<sup>114</sup>

The checklist in Box 7 contains key questions that might start you thinking about your company's environmental performance:

## Box 7

### Environmental checklist for industrial and resource-based companies

#### Role of the Board

Does your Board take a serious interest in environmental matters aside from dealing with high profile crises?

#### Strategic thinking

Is your company thinking strategically about the risks and opportunities it faces from its environmental performance?

#### Codes and principles

Is your company a signatory to an industry code, such as Responsible Care or the Australian Minerals Industry Code for Environmental Management? If so, do you do more than the minimum required by the Code?

Have you considered adopting international environmental principles, such as the CERES principles? Why haven't you adopted them?

#### Environmental management system

If you have an environmental management system, is it a core part of the overall management of all departments of your company? Or does it really function more as a showpiece on which you take the minimum actions necessary to remain certified?

#### Eco-efficiency

Does your environmental thinking go well beyond compliance to determine how your business could be operated differently to become eco-efficient?

Has your company looked at ways to convert its environmental costs into value-adding opportunities?

#### Climate change

What is your company's attitude/public position on climate change issues?

How exposed is your company to introduction of policies or programs that would impose new charges on carbon use?

What are you doing to reduce your energy use or other sources of greenhouse gas emissions?

#### Products

How energy efficient are your products?

Have you looked carefully at ways to improve their efficiency?

Have you had energy efficiency experts look at your products to identify potential improvements that you may overlook?

Have you applied the principles of eco-design/'design for the environment' to your products? Have you sought advice about potential improvements?

## Suppliers

Do you include environmental criteria in your selection process for suppliers, contractors and purchases?

## Environmental stakeholders

Do you have regular meetings with your stakeholders who are concerned about environmental issues?

Do your meetings allow stakeholders to present their concerns?

Are stakeholders' concerns made known to the Board?

How do you respond to the concerns raised by stakeholders?

## Public information

How much do you tell your customers and other stakeholders about your products and your activities?

Do you provide information that tells customers how to use your product(s) efficiently?

What information do you withhold from your stakeholders?

Why do you withhold this information?

What would happen if you made it available?

Are your company's public statements on the environment an accurate reflection of company operating policies and practices?

## Environmental and sustainability reporting

Does your company produce an annual environmental or sustainability report?

Does it use the Global Reporting Initiative (GRI) guidelines?

What types of information that stakeholders might find interesting or useful do you omit from the report? Why?

Who prepares your report? Are they knowledgeable about the environmental issues of interest to your stakeholders and about stakeholders' information needs?

Who is the target audience?

Does the report present information in a form that financial analysts can understand?

Is data comparable from year to year?

Is the data in the report comparable with data provided by others in your industry sector?

Is your report externally verified by an independent organisation? If not, why not?

## Promoting performance among Toyota's suppliers

Toyota sees ISO 14001 as an important strategic tool as it forces individual production areas to be responsible for day-to-day compliance and continuous improvement. A commitment to certification means everyone at Toyota is responsible for the environment, not just the 'Environment Group'.

Toyota first achieved certification at its Altona Plant in January 1998, followed by the Port Melbourne Plant in March 1999. Toyota also considers suppliers as an important consideration in Toyota's approach to sustainability and therefore encourages suppliers to become certified.

Through a process of consultation, Toyota found that many of its suppliers, particularly small to medium-sized enterprises (SMEs), viewed certification as a daunting task. In response, and with the assistance of an EPA Cleaner Production Grant, Toyota produced a supplier manual to promote the concept of ISO 14001 certification and the implementation of environmental management systems to SMEs. The grant also enabled Toyota to work directly with one supplier, Empire Rubber, to assist them in achieving certification. This approach will be used as a model to encourage other SMEs to aim for certification.

For further details on Toyota's environmental initiatives, see [http://www.toyota.com.au/index\\_showroom.asp?ForceNav=envtech](http://www.toyota.com.au/index_showroom.asp?ForceNav=envtech)

Case study from Towards Sustainable Development, Business Council of Australia<sup>114</sup>

## MYOB takes account of environmental performance

MYOB is an Australian producer of accounting software, focusing particularly on small business. Its shares are held by socially responsible investment funds, and its CEO was the keynote speaker at the first conference of the Ethical Investment Association. MYOB takes an active interest in environmental issues and makes its activities known, both through its website and other public information. It has won awards for its activities.

The types of environmental activities undertaken by MYOB are not exotic or difficult; many other companies could readily adopt them. It set up a "green team" several years ago to encourage staff involvement in reducing the company's environmental impact. Recycled paper is used for stationery and laser printers. Manuals are printed on paper made from plantation timbers, primarily Australian-grown. The company recycles the paper and cardboard it uses. And the company makes a real effort to minimise paper use: it manages to function effectively without a single copy machine!

MYOB has also become a member of Energy Smart Business, a voluntary program to encourage energy efficiency. It actively looks for ways it can make its buildings and its operations more energy efficient, and has implemented energy efficiency measures to reduce energy consumption in lighting, air conditioning, and operation of computers. Its newest building was designed to incorporate energy efficient features. Staff are given training in being 'energy smart', and are encouraged to offset the environmental cost of running their vehicles by contributing to the Green Fleet tree-planting program.<sup>115</sup>

## *Environmental issues—For financial and service companies, retailers and small manufacturers*

Until recently, environmental issues associated with companies were, in most people's minds, related to mining, large projects in sensitive locations, emissions or disposal of hazardous substances and the like. When banks, for example, were asked about their environmental activities, they commonly responded by describing their energy conservation programs or their procedures for recycling paper.

In the past few years, though, environmental groups have become more sophisticated, challenging projects seen as environmentally damaging both through the company proposing the project and through their major financial backers as well. Among the shareholder resolutions planned for introduction at US annual general meetings this year are dozens aimed at banks, insurance companies, other financial service providers, retailers, fast food chains and others. Most of these resolutions address environmental or social issues.

Companies in office-based or service industries may have significant environmental impacts either directly or through the activities they facilitate. (The vast bulk of office paper used, for example, is consumed in these companies. The availability and cost of recycled paper could change dramatically if a much larger number of companies promoted its use.) Box 8 provides a checklist of some possible environmental actions.

Even companies with relatively minor environmental impacts can distinguish themselves from their competitors and gain the attention of socially responsible investors by taking a real interest in environmental matters and making their activities known to the public and the financial community.

### *Examples of sector-specific environmental issues*

The list below is just a starting point for identifying the issues specific to your industry and your company. One of your early activities could be a brainstorming session to add to the list.

#### *Financial services*

- Implement procedures to take account of the environmental risks associated with your lending, insurance, and investment policies
- Promote policies for reduction of greenhouse gas emissions so as to reduce long-term environmental and financial risk

- Consider endorsement of the CERES Principles and/ or the United Nations Environmental Program Statement by Financial Institutions.
- Advise clients on how they can reduce their environmental risks.

#### *Retailing*

- Investigate the potential for promoting and providing information to your customers on environmentally preferable products, such as those made from recycled materials and those that are energy efficient
- Reduce packaging wherever possible; make use of recycled materials in packaging
- Lighting may be a major energy use. Examine ways to improve the efficiency of your lighting.

#### *Food services*

- Energy and water use can be significant; look particularly at energy used in cooking, refrigeration, air conditioning and water heating to identify ways of improving efficiency.

### **Box 8**

#### **Environmental checklist for financial and service companies, retailers and small manufacturers**

Businesses vary widely in the range of activities they carry out and the opportunities they have for improving their environmental performance. The following ideas are just a starter; each type of business will have many additional ways that are specific to its activities.

- Adopt an environmental policy or set of environmental principles to provide a framework and guide your environmental activities. Communicate your statement to all stakeholders and make it freely accessible in the workplace.
- Prepare an environmental report either as a separate section in your Annual Report or as a stand-alone document. Ensure that information in the report is written to meet the needs of both general public and financial sector stakeholders.
- Examine the environmental impacts of your core business, services provided to customers, and internal operations
- Determine the energy use associated with your buildings and operations; identify and implement measures to improve your energy efficiency, obtaining expert assistance where appropriate
- Analyse the energy use associated with use of transport by your business and its employees. Implement measures to reduce your transport-related energy consumption.
- Seek, encourage and give preference to suppliers and subcontractors whose environmental practices meet the standards the company sets for itself.
- Actively promote the use of environmentally preferable products, such as those made from recycled materials and energy-efficient equipment
- Encourage the participation of your employees in environmentally-related activities both in the workplace and in the community. This can multiply your effectiveness many times over.
- Consider the land-use implications of your activities and the siting of your facilities, such as branches and stores
- Analyse the risks and opportunities associated with environmental implications of your activities

## Property development

- Encourage the construction of energy-efficient buildings and homes, publicising the ongoing cost savings from energy efficient building design and appliances
- Look at the land use implications of developments; examine potential for improving public transport access
- Implement measures for reducing stormwater flows from new development
- Encourage the use of water-efficient landscaping

### Wharington International-developing environmentally preferable products

Producing innovative products can help companies gain competitive advantage, save money in manufacturing, as well as reduce environmental impact. Wharington International, Victorian-based manufacturers and engineers, developed Recopol™, an ABS resin that incorporates from 25 to 100 percent recycled materials, depending on the quality of the plastics recycled. Recopol™ resin can be used instead of timber or virgin plastics for producing the internal framing for upholstered furniture, lowering the cost and environmental impact.

A collaboration that drew on Wharington's materials, the furniture design skills of MID Commercial Furniture, the expertise in 'design for the environment' of the Centre for Design at RMIT, and a grant from EcoRecycle Victoria, led to development of the 'Re-Define' range of sophisticated commercial furniture. Some of the key environmental aspects of the furniture range include minimising the amount of foam used for padding and re-using scrap foam; use of Recopol™ recycled resin internal shells, recycled PET fabric for upholstery, fastenings designed to simplify the upholstery and enable easy removal for cleaning, elimination of toxic coatings on legs and other components.

For further information: Wharington International:  
phone: (03) 9544 5533; website:  
[www.wharington.com.au](http://www.wharington.com.au)

Centre for Design at RMIT: John Gertsakis, Acting  
Director: phone (03) 9925 3485; email:  
[john.gertsakis@rmit.edu.au](mailto:john.gertsakis@rmit.edu.au)

## Social issues—For all companies

Social issues are assuming a higher place among public concerns about company performance. Workplace issues, performance in other countries, community relations, selection and monitoring of suppliers, transparency and accountability are all frequently raised today. Key issues

influencing people's impressions of a company relate to its social responsibility: its labour practices, business ethics, responsibility to society at large, or environmental impacts.<sup>1</sup>

## Workplace issues

*"My only two passions are employees and customers. Because if I don't look after my employees, they won't look after our customers."*

John Chambers, President,  
Cisco Systems

Companies that have positive relationships with their employees improve their standing in the community and their long-term viability. Opinion leaders cite 'respect for employees' as the issue most affecting a company's reputation.<sup>5</sup> The treatment of employees affects not only the morale of staff, and their productivity, but also the ability to recruit new staff, community and customer attitudes and purchasing behaviour, and the views of socially responsible investors.

Some of the key workplace issues, beyond complying with all applicable legislation regarding employees' remuneration, benefits, working conditions, and occupational health and safety, are shown in the checklist in Box 9.<sup>16</sup>

Respect for employees is critical to the success of any business. Without productive employees you have no business.

## Marketplace practices

Surveys cited in Part I of this guide<sup>1,9,14</sup> document a large and growing market for products and services of socially responsible businesses. Consumers are increasingly integrating their social and environmental values into their purchasing choices—and are seeking to support companies that deliver on their core values. The rapid uptake of Green Power—electricity from renewable sources, made available at premium rates—demonstrates that a growing number of Australian consumers are willing to spend their money in line with their values.

A few characteristics of the way socially responsible businesses carry out their marketplace activities are shown below. These are only starting points; with a little effort you can come up with additional ways in which your company can demonstrate its socially responsible performance and distinguish itself from its less alert competitors.

- comply with all relevant consumer protection laws and regulations
- carry out your marketing in a truthful way
- ensure that advertisements and marketing do not discriminate against or stereotype any person or group
- prominently display customer satisfaction policies, covering policies on return, exchange, and guarantees. Also display your customer service telephone number and email address on products or in the retail establishment
- resolve customer or supplier disputes quickly and fairly

## Accountability

Stakeholders are increasingly demanding transparency and accountability from companies. Business has a responsibility to be accountable, not only to its shareholders, but to all its stakeholders. A few of the basic characteristics of a company that recognises its need to be accountable are itemised below. After taking stock of your current position, you can examine ways in which you can become more responsive to your stakeholders' expectations. Accountability is one of the important features that socially responsible investors look for in companies.

- conduct regular reviews of social and environmental policies and initiatives

### Box 9

#### Checklist of workplace issues

- fairness in recruitment, hiring, and promotion
- encouragement of more open Board membership
- clear and documented guidelines for employee development and advancement
- support for professional and personal development through internal training programs, financial assistance and/or flexible work hours for programs outside the organisation
- a work environment that allows for freedom of association
- fair and prompt payment to all employees, contractors and suppliers
- provision of mechanisms for employees to advance ideas and suggestions for change and for response to suggestions
- rewards for employee suggestions that provide benefits to the company
- clearly defined opportunities for management/staff communication and feedback, in all departments and at all levels within the organisation
- performance and contract review of all employees and contract workers at least annually; the process should provide employees/contract workers with the ability to review management and/or the company as well
- opportunities for employees to share in the growth and profitability of the firm, through initiatives such as bonus packages, profit sharing, share ownership plans and/or stock option arrangements
- implementation of programs to help employees balance work and family responsibilities, such as flexible working hours, job sharing, parental/family leave policies, and telecommuting options
- fairness in selection of contractors and suppliers; where possible preference given to local firms; provision of mechanisms whereby small contractors and suppliers gain access to procurement decision-makers
- written policies regarding termination, available to all employees for review
- investigation and, where appropriate, implementation of alternatives to downsizing and redundancy
- adequate advance notice of redundancies, and assistance to employees in locating alternative employment

- prepare a written public policy that commits the company to full public disclosure and the protection of internal critics (whistle blowers)
- anticipate and respond to stakeholder concerns about the potential social and environmental hazards and impacts of your products, services, and operations
- report your financial position and environmental and social performance to stakeholders in an accurate, clear and timely manner
- develop opportunities for work placements, internships or similar in-house training, delivered in partnership with local educational institutions or community organisations where appropriate
- donate at least 1% of pre-tax profits to charitable organisations (averaged over three years), of which half may be contributed in volunteer time and/or donations in kind.

## Community development

Business publications increasingly use the phrase earning a ‘license to operate’ when they discuss a company’s obligations to form partnerships that benefit the communities in which the company is located. Dow Chemical says:

*“Partnering with our communities is a tradition at Dow and an important business practice. Our communities hold our license to operate, and broad support is critical to our business success. Our philosophy is to invest in our communities and encourage them to invest in themselves.”<sup>17</sup>*

The Business Council of Australia outlines the business case for community corporate involvement:

*“Community involvement expands the definition of good corporate citizenship to include contributing money, time, products, services, leadership or other resources to the community in which the company operates. These resources primarily meet social and economic needs in the community. They also strengthen the link between business objectives and the life of the community.”<sup>10</sup>*

Some basic elements of community involvement are listed below. Your company’s situation and community are unique, so appropriate community involvement activities should be designed to address your particular circumstances.

- make an explicit commitment to community well-being; produce your community partnership policy in written form and make it publicly available
- commit to creation of enduring community partnerships and long-term relationships that contribute to the quality of life in the community
- provide information on local and regional social and environmental issues to stakeholders through events and services, including company newsletters, ‘brown bag’ lunches, and public bulletin boards

## Alcoa’s Community Consultative Networks

Alcoa considers stakeholder communication to be an open, two-way process, with listening and dialogue shared between all parties. Alcoa has used an interactive approach for its Community Consultative Networks (CCNs) in Western Australia at the Kwinana, Pinjarra and Wagerup Refineries. While there are a number of compelling reasons why Alcoa established CCNs, the foremost was a desire to strengthen relationships with neighbours and local communities.

The first of Alcoa’s CCNs were set up at the Kwinana and Pinjarra Refineries in December 1994. The most recent addition to this effective community forum was the CCN at Wagerup Refinery that began in June 2000.

A key role of the CCN groups at each of the refineries is to provide members of the community with an opportunity to raise issues, ask questions and develop an understanding of Alcoa’s operations.

For Alcoa, the CCNs have an important role in providing a realistic touchstone of community attitudes. Alcoa has a vital opportunity to find out about community expectations, needs and concerns regarding its operations and then work with the community to address them.

Alcoa’s Refinery Management Teams, through the Kwinana, Pinjarra and Wagerup CCNs, also have a forum to feedback to their communities on how Alcoa will respond to the issues raised through the groups.

While the CCNs have a pivotal role to play in working with the community, they are not the be-all and end-all of community consultation at Alcoa, but they do provide a relevant starting point for community consultation relating to Alcoa’s refinery operations.

For further information on Alcoa’s environment health and safety initiatives, see <http://www.alcoa.com/au/environment/index.shtml>

Case study from Towards Sustainable Development , Business Council of Australia<sup>14</sup>

## Ford Australia and Youth At Risk

As part of its Corporate Citizenship program, Ford Australia has developed a partnership with Youth At Risk (Australia) Inc. to assist young people deemed 'at risk' to prepare for and seek employment in their local area.

In conjunction with the local councils of Hume and Geelong (Victoria), Ford Australia employees and Youth At Risk volunteers conduct two events per year to assist in promoting a sense of community amongst the youth, business and councils. "Interviewing Your Future" is a five-day event that provides a conference-style forum for 40-50 young people aged between 16-23 and focuses on preparing participants for employment.

Participants not only complete the program feeling more confident about their abilities and what they have to offer, but they also create professional resumes, learn how to present themselves at an interview and develop a good set of problem solving and presentation skills.

Most importantly, the young people move into a two month mentoring phase, partnered with a mentor from Ford, which is designed to support them as they make the transition into the workplace.

The program also provides personal growth opportunities for the Ford employees involved, including a 2-day advanced communications skills workshop, and assisting the well being of local communities.

For further information on the Ford Australia Youth At Risk partnership and other Ford community service partnerships, see [www.ford.com.au/inside\\_ford/community/projects/Community\\_Projects.asp](http://www.ford.com.au/inside_ford/community/projects/Community_Projects.asp)

Case study from Towards Sustainable Development ,  
Business Council of Australia<sup>114</sup>

## International relationships

A number of well-known companies have attracted great criticism for some overseas activities within the past few years. With the speed of communication today, anything significant a company does anywhere is known almost instantly by people around the world. Responsible companies demonstrate their environmental and social performance wherever they operate. Some initial provisions for maintaining good international relationships are listed below.

- prepare codes of conducts and monitoring mechanisms to ensure the company does not engage in corrupt practices wherever it operates; participate in Transparency International activities to end corrupt practices
- comply with human rights standards as outlined in the United Nations Universal Declaration of Human Rights
- adhere to appropriate social and environmental standards in host countries equivalent to those applicable in Australia. Produce clear written guidelines for ensuring fair employment and meeting environmental standards in international operations. Make the guidelines available for review by all employees, suppliers and contractors

- to the maximum extent possible, ensure that products manufactured by the company or its suppliers are not produced using child labour or forced labour, or under sub-standard working conditions
- give preference to local employment and suppliers
- make an effort to ensure that the company's international operations will not lead to displacement of existing communities

As described in Part I, companies that maintain strict company standards wherever they operate also do better financially.<sup>53</sup>

## Actively planning and managing for the future

*Living at risk is jumping off a cliff and building your wings on the way down.*

Ray Bradbury

Pressures on business to improve its environmental and social performance will inevitably continue to increase over the next decade. The momentum towards

achievement of sustainability is unstoppable. Businesses in advanced countries like Australia will be expected to play a significant part in ensuring that all people in the world have a decent quality of life and in protecting the ecological systems and processes on which all life depends.

Business-as-usual won't get us there. Companies that assume that they can 'make it up as they go along' will lose out to competitors who strategically plan for ways they can turn challenges into opportunities.

The World Business Council for Sustainable Development (WBCSD), in its recent report *Sustainability Through the Market: seven keys to success*,<sup>118</sup> acknowledges the difficulty of the task. It notes though, "We believe there are tremendous opportunities for companies to drive profitable growth by providing products and services that improve people's lives in both the developed and especially in the developing countries. We believe those companies which stretch their imaginations in doing this will generate higher shareholder and societal value. The upside opportunities are huge. So are the downside risks. We cannot afford to fail..."

Australian business has been repeatedly criticised for its low expenditures on research and development. Australian manufacturers at one time mainly supplied their products to Australians who had little recourse to products from overseas. That situation is no more. And the vast markets of the developing world will respond to energy efficient, ecologically sound products because they cannot afford to do otherwise. The infrastructure to supply energy for the required millions of new refrigerators and washing machines alone would be prohibitive, in both financial and ecological terms.

Good products are not the only challenge. Today's skilled professionals do not spend their working lives in one company. They have the option to look for companies offering challenging work in a pleasing environment, and they will not be available to companies that are not seen as forward thinking.

Taking action today to satisfy future stakeholder needs is probably more difficult. It requires the development of innovative approaches to the company's business, so that products, services and other company actions help fulfil growing demands for moving to sustainability. It also means anticipating the risks that the company will face in the future, whether from more stringent environmental requirements from society, increasing global competition or other factors, and managing the company today so that those risks are turned into opportunities.

Meeting the challenges of tomorrow and attracting future investors will require well-developed processes for strategic planning, recognition of needs and opportunities, and good managers and thinkers to make it all happen.

## Conclusion to Part 4

Demonstrating good environmental and social performance is becoming an important element of attracting capital. A company has many opportunities to improve performance in ways that also reduce cost and add value to its operations. Communicating information about environmental and social performance in a manner that meets the needs of the user is also critical.

An essential component of socially responsible performance is maintaining good relations with the company's wide range of stakeholders. The reputation of a company is based to a large extent on what stakeholders say about it. Today's investors concerned about more than financial performance place great value on a company's reputation among its stakeholders.

Companies who do not consider that they have major environmental or social issues affecting their activities can still call to investors' attention the company's environmental, workplace and community activities. But today's investors and other stakeholders are becoming quite sophisticated in seeing through empty, inflated or irrelevant claims, so it is important to provide useful information about real activities. Particularly important is information about how the company carries out its core business in a socially responsible manner.

Investors are looking for assistance in deciding among companies in which to invest. By demonstrating good environmental and social performance and by communicating information about performance in a manner meaningful to a potential investor, a company helps encourage an investor to select that company among the many choices available.

Although socially responsible investors are currently likely to be the group most interested in a company's environmental and social performance, a growing number of mainstream investors, lenders and insurers are also looking much more closely at these aspects of companies. Meeting the requirements of socially responsible investors helps ensure that your company will stand up to the future scrutiny of the broader financial community.

## PART 5— Some Useful Resources

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### Environment and sustainability for business and the finance sector

#### *Environment Australia*

[www.ea.gov.au](http://www.ea.gov.au)

The Environment Australia website contains information on cleaner production and eco-efficiency, recycling, waste minimisation, chemicals and the environment issues, wastewater, stormwater, and water quality. It includes details of legislation, the National Packaging Covenant, and a wide range of other environmental information.

<http://www.ea.gov.au/industry/sustainable/finance/index.html>

A resource and information source for the Australian financial services sector. The site links to a number of related sites within Australia and globally, and contains a list of publications and further information. It also provides access to a range of related initiatives being carried out by Environment Australia.

#### *Coalition for Environmentally Responsible Economies (CERES)*

[www.ceres.org](http://www.ceres.org)

This US non-profit organisation is a coalition of investors, public pension funds, foundations, labour unions, and environmental, religious and public interest groups, working in partnership with companies toward a common worldwide goal of corporate environmental responsibility. CERES has produced a set of environmental principles for businesses (formerly called the Valdez principles).

#### *SustainAbility (UK)*

[www.sustainability.co.uk](http://www.sustainability.co.uk)

SustainAbility pioneered the term Triple Bottom Line. Its director, John Elkington, is one of the leaders in promoting the business case for sustainability. This site gives a good overview of their far-reaching triple bottom line work, and provides free access to a number of their reports, including Buried Treasure, which describes the links between sustainable development and business performance.

#### *EPA Victoria-United Nations Environment Programme Finance Initiatives*

[www.epa.vic.gov.au/programs/UNEP/Financial\\_Initiatives.shtml](http://www.epa.vic.gov.au/programs/UNEP/Financial_Initiatives.shtml)

The Initiatives aim to engage a broad range of financial institutions in a constructive dialogue on economic development, environmental protection, and sustainable development. They promote the integration of environmental considerations into all aspects of the financial sector's operations and services. EPA Victoria has signed a Memorandum of Understanding to co-ordinate and promote UNEP's Finance Initiatives activities in Australasia.

Activities include holding meetings, seminars and conferences in Australasia, establishing and chairing Australasian advisory committees on environmental issues in the financial services sector and publishing regular UNEP newsletters. Its advisory committees include financial institution representatives and cover several topics: Socially Responsible Investment, Environmental Credit Risk and Internal Operational Management of Companies.

#### *The World Business Council for Sustainable Development (WBCSD)*

[www.wbcsd.ch](http://www.wbcsd.ch)

World Business Council for Sustainable Development members are united by a shared commitment to sustainable development, i.e. environmental protection, social equity and economic growth. The Business Council of Australia is its local partner. The WBCSD aims to develop closer co-operation between business, government and all other organisations concerned with the environment and sustainable development.

The WBCSD website includes information on trade and the environment, natural resources, innovation and technology, climate and energy, eco-efficiency, the Global Compact, and corporate social responsibility. Some publications are available on line or for download; others can be ordered through the website.

## Environmental and social reporting

### *Environment Australia*

<http://www.ea.gov.au/industry/sustainable/per>

Public environmental reporting is described on this website. Information provided includes reasons and tools for preparing a public environmental report, examples of Australian and overseas reports, links to related sites, and access to free downloading of “A Framework for Environmental Reporting”.

### *Global Reporting Initiative*

<http://www.globalreporting.org>

The Global Reporting Initiative (GRI) is developing universally applicable guidelines for reporting on economic, environmental, and social performance. Convened by the Coalition for Environmentally Responsible Economies (CERES) in partnership with the United Nations Environment Programme, the GRI incorporates the active participation of corporations, NGOs, accountancy organisations, business associations, and other stakeholders from around the world. The GRI's Sustainability Reporting Guidelines were released in draft form in March 1999. They represented the first global framework for comprehensive sustainability reporting, encompassing the ‘triple bottom line’ of economic, environmental, and social issues. Revised Guidelines were released in June 2000 and are available for download from the website.

## Corporate social responsibility and socially responsible investing

### *Business for Social Responsibility (BSR)*

[www.bsr.org](http://www.bsr.org)

Business for Social Responsibility (BSR) is a US-based global resource for companies seeking to sustain their commercial success in ways that demonstrate respect for ethical values, people, communities and the environment. BSR's online Global Business Responsibility Resource Center is a comprehensive worldwide information resource on corporate social responsibility, including the business importance of CSR.

<http://www.bsr.org/resourcecenter>

### *Ethical Investment Association (Australia)*

[www.eia.org.au](http://www.eia.org.au)

The Ethical Investment Association is a professional organisation formed to pool the efforts of those involved in the industry, including fund managers, financial advisors, researchers, individuals, entrepreneurs, companies and government. It aims to promote the concept and practice of ethical investment to the public.

### *Social Investment Canada, Social Investment Forum (US), Social Investment Forum (UK)*

[www.socialinvestment.ca](http://www.socialinvestment.ca)

[www.socialinvest.org](http://www.socialinvest.org)

[www.uksif.org](http://www.uksif.org)

Each of these organisation's websites contains a wealth of material on socially responsible investing, community investment, shareholder action, as well as background information, publications and links to other related organisations. They serve as excellent jumping-off places to issues of social responsibility.

### *EthicsWeb (Canada)*

[www.ethicsweb.ca](http://www.ethicsweb.ca)

Information on how to develop a code of ethics, articles, case studies, resources, and other resources. Primarily Canadian, but with links to international sites.

### *The St James Ethics Centre*

<http://www.ethics.org.au/>

The Centre is an independent non-profit, non-political organisation that provides a forum for the promotion of business and professional ethics. It has offices in both Sydney and Melbourne. Its website describes the activities of the Centre and includes some articles from its newsletter.

### *Additional Sources*

References throughout this guide generally include web addresses for obtaining further information about the specific issue cited.

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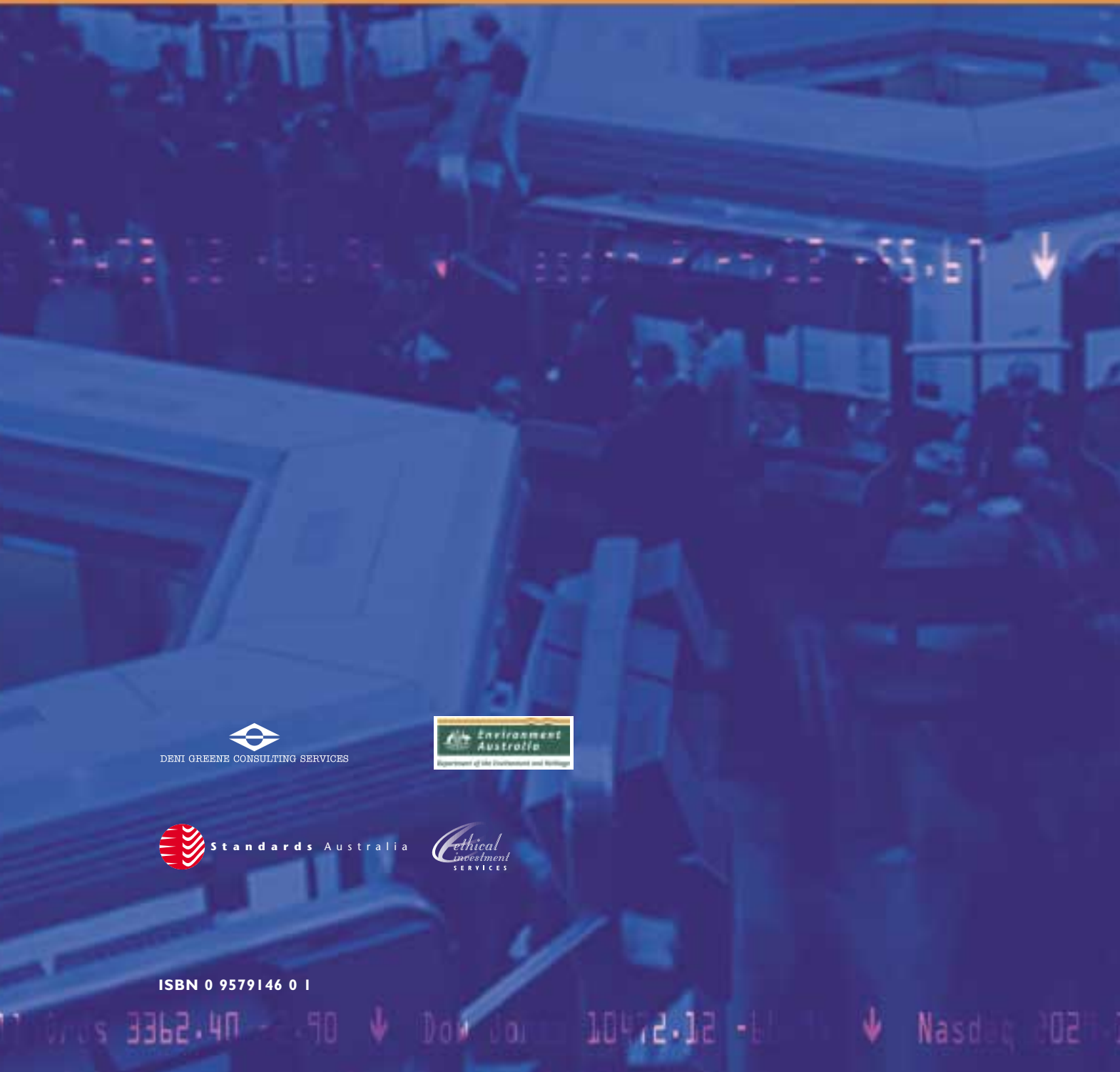
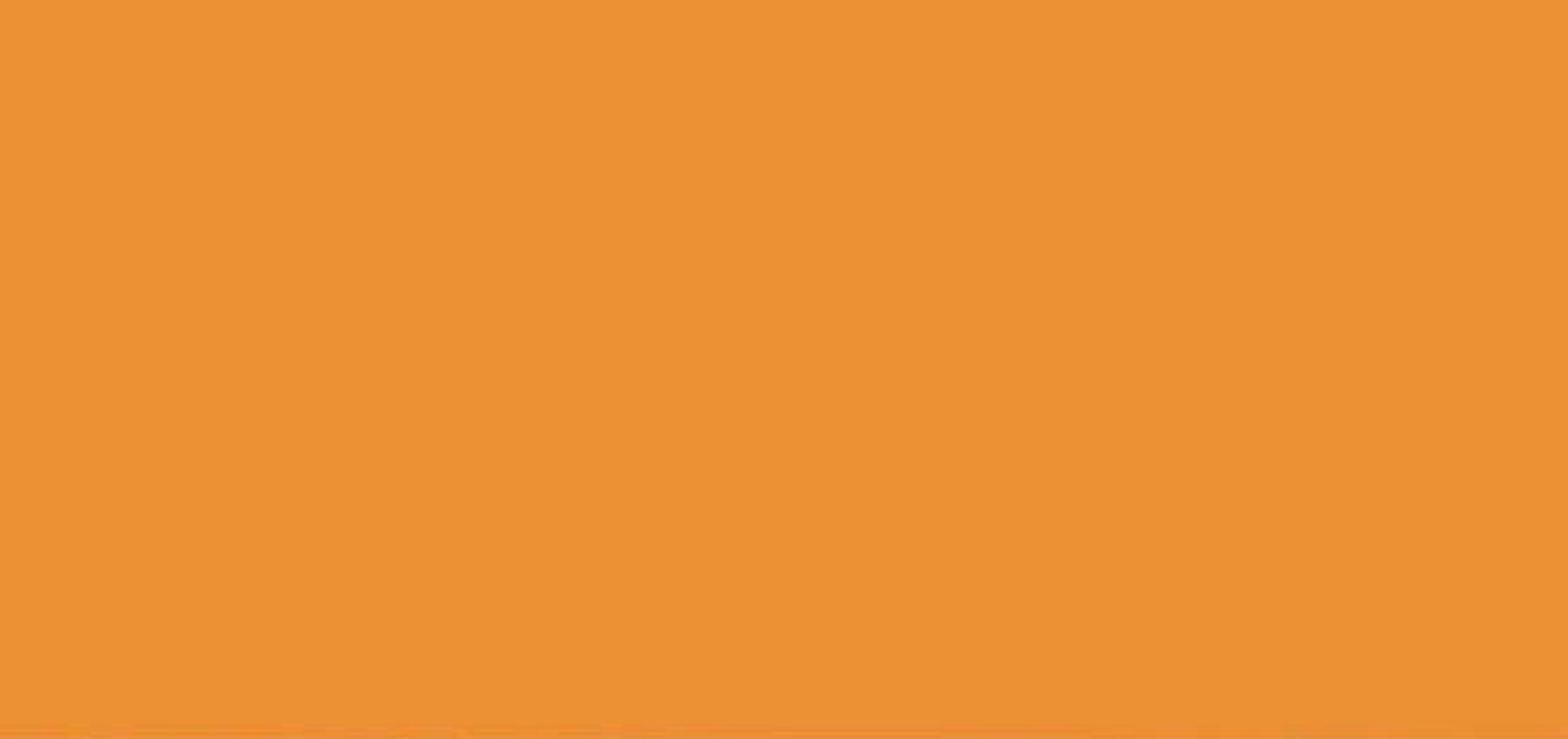
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